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INVESTMENT CRITERIA FOR THE MARINE OFFICER

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INVESTMENT CRITERIA FOR
THE MARINE OFFICER

by

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PREFACE

This report is predicated on the assumption that a large majority of the United States Marine Corps officer profession is more than superficially interested in the art of investing in marketable securities. And further, that many individuals in this group have constrained this interest to no more than a stimulating topic of conversation due to a feeling of personal inadequacy in financial scholarship.

It originated in the writer's desire to record the substantial amount of investment information which he has acquired during the past year in his pursuit of higher education, in such a way as to be meaningful and informative to those associates who have not been afforded the opportunity. It is primarily directed to those Marine officers who possess the resources and the desire to invest, in anticipation that such a work will reduce any anxiety they may possess because of an absence of understanding in this challenging field of endeavor.

The paper has been written in such a manner that even a novice among investors will be more conscious of the problems involved, the principles and practices followed, and some of the techniques employed in investing. It is not intended to encompass all existing investment doctrine nor is it designed to document or even suggest any particular course of buying action for a potential investor.

The emphasis of the report is specifically toward investment criteria as applicable to the Marine officer personnel and hence much of its context lies within the framework of their career pattern and occupational requirements.

Such is the process of learning that it is quite impossible to trace exactly the source of any given body of knowledge. This circumstance is no less true in the preparation of a report of this type. It is the product of many different writers and investment authorities. In general, the writer acknowledges his indebtedness to these individuals.

In particular, however, this officer is grateful for the assistance rendered him by Dr. James C. Dockeray of George Washington University whose proficiency as an instructor in this area prompted the writing of the paper and whose direction made it possible.

Daniel J. Ford

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In a letter to his son, Lord Chesterfield penned this bit of wisdom: "Dispatch is the soul of business and nothing contributes more to dispatch than method."

There is little doubt that, to facilitate profitable investment, methodology must outrank fortune. One can cite many instances, to be sure, where luck has been a distinctive feature of successful investment; but those who have continually experienced substantial returns on their invested funds have also possessed a broad knowledge of the essentials of the art.

The art of investment has one characteristic that is not generally appreciated. A creditable, if unspectacular, result can be achieved by the lay investor with a minimum of effort and capability; but to improve this easily attainable standard requires much application and more than a trace of wisdom.[1]

The number and variety of the writings which set forth, and digress upon, the principles of investment seem infinite. Books range in form from the hard-cover professional tome to the paper-bound opus for the enlightenment of the do-it-yourselfer. Periodicals and "trade papers" encompass a myriad of stylistic approaches: the cut-and-dried definitiveness of Standard & Poors Stock Listings; the dollars-and-cents politicing of the Wall Street Journal's

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[1]Benjamin Graham, The Intelligent Investor (New York: Harper & Bros., 1954), p. xiii.

editorials; the play-by-play battles of the bulls and bears according to Barron's Weekly; the mathematical delights of Moody's Industrials.

Nonetheless, in the midst of this extensive diversification, there does exist, common to practically all, a core of basic investment doctrine. To this set of precepts can be attached the phrase "methodology of investment."

It is with these rudimentary data that this paper is concerned. The purpose of this report is to present under one cover those essential facts of investment life, designed specifically for the Marine officer profession and intended to assist them in making soundly based decisions in the investment of personal funds. This report is restricted to the collection and synthesis of accepted principles and is devoid of recommendations for any specific course of action. These judgments are -- as they should be -- left to the individual's prerogative. The author does not presume to give personal counsel on particular investment problems.

Like any other type of professional, the Marine officer bases his operations upon a firm structure of proven principles and well-established practices. And, given the methodology of investing, he should, like other professional men, be able to assume the position of a successful shareholder capably and competently.

The compilation of this report is intended as an aid to that end. It will furnish background information, salient details, and, hopefully, perhaps a modicum of incentive. But it does not pretend to guarantee successful investment any more than a military manual insures successful combat operations. As Stearns points out:

> We Americans have an abiding faith in education, practical "scientific" systems, and experts. Many people believe that they can learn anything by reading a book or taking a course. Yet, although knowledge is democratic, it is rarely of value except as a springboard from which imagination and judgment can take off. All the books and courses in America won't alone make a good lawyer or doctor or copywriter, or a good investor. Yet millions of people arrogate to themselves, on the basis of very little knowledge and even less hard thinking, the ability to use sound investment judgment.[2]

Part I of the report is devoted to the inauguration of the Marine officer into the ranks of more than 12,400,000 American shareholders, and his comparison with the average group. Herein the compatabilities and incongruities of these two groups (Marine officer and average shareholder) are discussed with emphasis being placed upon the peculiarities of the military occupation. Although the stockholder group is very diffuse, few members are subject to the exigencies of a typical Marine officer's career pattern. In this section the vital statistics (income group, education, occupational status) of the American stockholder will be discussed and compared with those of the Marine officer. In further elaboration, the general economic aspects of American capitalism will be briefly referenced.

Part II is allocated to a synthesis of an overabundance of investment information. Although not in an all-inclusive manner, the requisites of sound investment are discussed in four broad categories: (1) the principal types of investment; (2) the individual's program; (3) security selection; and (4) folklore of the market.

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[2]Linhart Stearns, How to Live with Your Investments (New York: Simon & Schuster, 1955), p. xi.

While this thesis primarily addresses itself to that portion of the Marine officer's funds which he is prepared to place in marketable securities, in the first section of Part II the other types of investment available to an individual with sufficient resources are recognized and briefly discussed.

In section two of this part, reference is made to the various types of individual investment programming with the appropriate guidelines for each. Recognizing the individuality of each investor and the ensuing differences in personal objectives, income, education, and temperament, it has been previously inferred that no one set of investment criteria is categorically suited to meet the needs of all. However, various broad courses of investment action presumably consistent with the personal financial goals of most people are acknowledged.

Security selection is a phase of investment theory which in itself is worthy of an extensive report; but, for the purposes of this paper, a thorough discussion of security analysis is not required. A brief description of a suitable method of classifying the desirable attributes of industries and companies will .be made, however, and some of the criteria used in selecting individual securities will be outlined. "Selection of securities suitable for the investor's program is as important as the determination of an appropriate investment program."[3]

No presentation of the characteristics of either an art or a science would be even barely comprehensive without an explanation of the terms, techniques, functions and tools employed in that particular area. The final

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[3] E. C. Harwood, How to Invest Wisely (Pittsfield, Mass.: The Ben Franklin Press, Inc., 1955), p. 49.

section of Part II is devoted to a discussion of the many somewhat complex "tools of the trade" of the investment field. And, although, it is not considered vital to successful investment, an understanding of the nomenclature and colloquialisms peculiar to Wall Street does tend to make a shareholder feel more like a member of the club. Therefore, the author has included, at this point, some of the folklore of the market.

Also in this section will be found considerations of the variances between the over-the-counter market and the "big board," odd-lot trading versus round-lot buying, the use of put and call options, the functioning of the stock exchange, and the interpretation of financial news.

Part III examines the development of the Marine officer's portfolio. A framework of investment, structured upon specific principles which have been filtered from the more generalized methodology presented in Parts I and II of the report and deemed appropriate to the officer's particular circumstances, is offered. This program is not constructed on the basis of individual securities; and, the writer would again remind the reader, no personal plan of action is stressed or recommended.

This part is composed of two chapters: Chapter 7, a study of "automatic" and indirect investment; and Chapter 8, a commentary on speculative self-investment. The portfolios of the majority of individuals are derived from one or a combination of both of these investment categories. The knowledgeable investor may consider the inclusion of a section on "speculation" as incongruous in a paper of this sort. But the writer denies the exclusivity of this type of investment, and contends that it can prove profitable, as well

as challenging to the enterprising investor who possesses an adequate knowledge of investment theory.

"Automatic" investment, encompassing the mutual funds and the monthly investment program, is customarily recommended to those "men and women who would like to become investors but have not the time, nor the facts necessary, to choose among the thousands of stocks and bonds they might buy."[4] To touch only lightly on this subject in an examination of investment criteria for the Marine officer would, indeed, imply short-sightedness on the part of the writer. There is little doubt that the mutual funds and the monthly investment plans offer much to such a person. And this is where the emphasis will be placed in this report.

Chapter 7 is a comprehensive discussion concerning the various types of funds. This includes the open-end and closed-end funds, the types of securities generally owned by the funds, the advantages and disadvantages of this kind of investment, and, finally, an analysis of the performance of a selected few of these firms.

The final section of this thesis, Chapter 8, is reserved for what is perhaps the most exciting aspect of investment -- common stock speculation. To achieve any measurable amount of success in this field, however, one must be possessed of three fundamentals of varying degree: time, money, and knowledge. Not the least of these is knowledge. Augmenting this last requisite, if only as an incentive to the reader to investigate the broader areas of investment, is the design of this chapter.

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[4]John A. Straley, What About Mutual Funds? (New York: Harper & Bros., 1958), p. vii.

The Marine Officer's Guide offers this creditable advice to the profession as a whole:

> An investment program which includes both Government savings bonds and sound stocks should be one of your undeviating objectives. . . . Do not "play the market" or speculate. Try to build up a portfolio of well diversified, high quality stocks or bonds with long records of past dividend payment.[5]

The intent of this counsel is laudable, and the truth of it is irrefutable when applied to Marine officers as a group or to individual officers who have no background as a foundation for informed investment. It is not necessarily applicable, and it is a moot point that it was meant to be, to those individuals who have a solid educational basis and previous practical experience in the field of investment.

Since the early 1900's, common stocks have not only become desirable but widely sought for long-term investment. There are several reasons for this: (1) the sustained growth of our economy; (2) the remarkable expansion in size and profitability of our great corporations; (3) the fabulous rise in dividend payments over the years; (4) the amazing fortunes made by even modest investment in many companies in their early stages; and (5) the defense common stocks have offered against inflation and a depreciating dollar.[6]

This writing will justify itself if, after thoughtful study and thorough assimilation of it, the regular Marine officer to whom it is directed,

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[5]Rear Adm. A. A. Ageton, Col. R. D. Heinl, Jr., and Gen. G. C. Thomas, The Marine Officer's Guide (Menasha, Wisc.: George Banta Co., Inc., 1956), p. 438.

[6]Ira U. Cobleigh, Guide to Success in the Stock Market (New York: Avon Book Division, The Hearst Corp., 1961), p. 19.

is provoked to giving more serious attention to and increased interest in, the state of his personal investment policy.

PART I

THE MARINE OFFICER AS AN INVESTOR

CHAPTER I

THE AMERICAN STOCKHOLDER

During the month of May, 1947, the New York Stock Exchange splurged with heavy advertising in Time, Look, Saturday Evening Post, Colliers, and other magazines. The advertisement showed a table covered with hats -- the ten gallon hat of a man from Texas, the denim cap of the railroad fireman, the crushed fedora one might associate with a rushed physician, the white cap of the house painter, the derby of the stockbroker, the homberg that President Eisenhower has since made popular, the wide-brimmed straw the farmer uses in the field, the dashing cap of an airman, and, to represent the women, a fur neckpiece. To this array can be added the impressive frame cap of the Marine major.

The title is "Stockholders' Meeting." The copy says: "They come from everywhere . . . from every income group, from every community. They are women as well as men, employees as well as executives, farmers as well as businessmen. They are typical stockholders, the owners of business."

. . . Corporations are owned by everyone. Wall Street is not a rich man's preserve. It is where Main Street as well as Park Avenue places its savings, where the millions of the millionaire and the tens and twenties of the widow and the schoolteacher commingle.[1]

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[1]J. A. Livingston, The American Stockholder (Philadelphia & New York: J. B. Lippincott Co., 1958), p. 22.

The Stockholder Defined

Although the foregoing paragraphs may paint a vivid word picture of what the American stockholder may be, statistics can more aptly define what he actually is. But the "typical" shareholder is difficult to describe. He is a member of a group of people who, in an analytical sense, can hardly be called a class. He is a member of a group which is not and probably never will be homogeneous; a group which has few champions but many exploiters; a group which at one moment displays general disinterest and at another rises to meet an issue.[2]

The stockholder is basically defined as "a person owning a share or shares of stock in a given company."[3] "He is the owner of a corporate enterprise."[4]

A share of stock, oddly, is just what it says it is -- a share of a business' hopes, plans and accomplishments. If one buys a share of General Motors, he is not buying an ornate piece of very good, crinkly paper, but a very real 1/280,840,000th of what General Motors has left over each year after it has subtracted from its tremendous gross income a certain amount for taxes reserves, labor, materials, advertising, research, and expansion. The whole thing is about as mysterious as making a theater reservation.[5]

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[2]Ibid., p. 16.

[3]Webster's New World Dictionary (Cleveland & New York: The World Publishing Company, 1960), p. 1436.

[4]Charles W. Gerstenberg, Financial Organization and Management of Business (New York: Prentice-Hall, Inc., 1951), p. 4.

[5]Don W. Campbell, Let's Take Stock (Indianapolis: Bobbs-Merrill Company, Inc., 1959), p. 13.

> People -- little people, big people, rich people, poor people -- own a piece of American Telephone & Telegraph, General Motors, American Can, Allied Chemical & Dye, General Electric, and Kansas City Power & Light. Common stocks are widely dispersed in a nation of great corporations and little capitalists.[6]

The "American" stockholder can best be distinguished from any other type by the following description of his arena: This is a great country, a wonderful society. The power of the place is visible. A visitor from abroad who traverses a narrow sector along the Pennsylvania Railroad from New York to Washington, sees endless roads strewn with endless lines of cars. He sees factories, automobiles parked at the factories. He sees cranes, derricks, hoists, shipyards. He sees America at work in a breathtaking panorama. If he has a chance to pause in any city, he sees a standard of living -- a manner of eating, sleeping, dressing, and playing -- unmatched anywhere. Ours is a consumeristic society. Incomes have risen steadily. Protections against old age and unemployment have rapidly developed and expanded since the depression 'thirties. Men and women feel more confident of finding jobs, earning a living, and having an income in their old age. They are more prone, therefore, to spend and borrow -- to mortgage future income and buy homes, automobiles, household appliances, home furnishings, cabins in the woods, and by the seashore, and kidney-shaped swimming pools."[7]

> The stockholders of America are the people who own, operate, and finance much of its business -- virtually all its more important business.[8]

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[6]Livingston, <u>op. cit</u>., p. 17.

[7]<u>Ibid</u>., pp. 17-18.

[8]Louis Engel, <u>How to Buy Stocks</u> (Boston: Little, Brown & Co., 1953), p. 6.

The Investor

Investment presumes the availability of funds over and above dollars required to finance personal consumption.

> A justly famous recipe for rabbit potpie begins with the sage admonition,"First catch the rabbit." The man whose income does not exceed expenses will have no investment problem, for he cannot prepare his potpie without first securing the essential ingredient.[9]

Investment is specifically indefinable in that it denotes different things to different people. To a great degree confusion surrounds the term simply because of the multiplicity of uses to which it is put. Extensive research reveals it to be an even more nebulous term. The meaning of investment to the economist is quite different from its meaning to the security salesman or to the man in the street. The economist, thinking in terms of economic theory will probably look upon investment as a productive process by means of which additions are made to capital equipment. From the practical viewpoint of the security salesman, on the other hand, investment may well be considered a merchandising process, in which he earns a living by placing his customers in contact with the best bargains. To the hypothetical man in the street, investment probably means an outlay of money in return for the expectation of gain in the shape of income or appreciation in value.[10]

This last concept of investment will best suit the needs of this paper. Specifically, the interest of this report lies in the problems and decisions of investment as defined by Dowrie and Fuller: ". . . the employment of capital

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[9] Robert V. Cooper, M. D., Investments for Professional People (New York: The MacMillan Co., 1959), p. 1.

[10] George W. Dowrie and Douglas R. Fuller, Investments (New York: John Wiley & Sons, Inc., 1950), p. 3.

with the aim of producing a gain in the shape of income or appreciation in value or both."[11]

This means that subsequent reference to the term investment will be in the prevalent financial sense of the placing of funds in the hands of others for their use, in return for a paper instrument entitling the holder to fixed-income payments or participation in expected profits.

Bellemore reaffirms this meaning in more general terms:

> The most amazing attribute of our economic system is its ability to produce in tremendous variety and quantity goods and services that have become an integral part of our lives. Although much has been written of the wonders of such a system, we tend to view the results rather casually since the factories and machines that produce them seem commonplace. We are essentially products of an industrial age and the present situation seems natural, although our factories and machines are far from natural for they represent capital goods created only to the extent people are willing to forego present consumption. They can be obtained only by saving a portion of the available current national income for their procurement. This considered employment of savings is popularly called investment.[12]

Many treatises on investment take care to define investment in contradistinction to speculation. "An investment operation is one which upon thorough analysis, promises safety of principal and a satisfactory return. Operations not meeting these requirements are speculative."[13] Evans and Barnett are more liberal: "An investment may be defined as an exchange of present for future funds where the receipt of the future funds is not

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[11] Ibid., p. 5.

[12] Douglas Hamilton Bellemore, Investments, Principles, Practices and Analysis (New York: B. C. Forbes & Sons Publishing Co., Inc., 1953), p. 1.

[13] Graham, op. cit., p. 3.

conditioned by the happening of a definite named catastrophe."[14]

Much disagreement, tainted with cynicism, flourishes among the experts as to the degree of distinction between the concepts of investment and speculation. The latter term will be discussed in the final stages of this report.

As has been pointed out previously, various modes of investment are available to the individual with adequate resources; he is by no means restricted to participation in corporate equity. Nonetheless, in the case of the Marine officer in this work, he will be oriented as a potential stockholder, since the investment criteria set forth herein will be concentrated in the area of marketable securities.

The Corporation

Probably the most famous definition of the corporation is the one given in 1819 by Chief Justice Marshall in the Dartmouth College case decision, in which he described a corporation as "an artificial being, invisible, intangible, and existing only in contemplation of law."

This definition emphasizes the basic characteristic of the corporation -- its separate legal entity. It is not a group of separate persons; it is itself a legal "person."[15] The corporation is a device for carrying on an enterprise in such a way as to constitute the enterprise itself an entity

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[14]George Herberton Evans, Jr. and George E. Barnett, Principles of Investment (Boston: Houghton Mifflin Co., 1940), p. 7.

[15]H. A. Finney and Herbert E. Miller, Principles of Accounting (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1958), p. 175.

entirely distinct from the persons who are interested in it and control it. The state authorizes its existence, and as long as it complies with the provisions of the law it continues to exist, irrespective of changes in its membership. It has an individual name by which it may enter into contracts; it may hold property; and it may sue and be sued.[16]

It is a means whereby the small and scattered money hoards of millions of individuals are gathered together into large aggregations capable of producing and distributing goods in quantity. To the extent that the corporation successfully performs this function, it will survive as an institution. Should it fail, it will die.[17]

The corporation is unexcelled as a medium for raising large amounts of capital. Its powers are so wide and its structure is so flexible that both may be adjusted to meet many diversified conditions.

Restricting the classification to private corporations, the following types may exist:

I. According to profit
  - A. Profit or stock
  - B. Nonprofit or nonstock

II. According to field of enterprise
  - A. Public utilities
  - B. Railroads
  - C. Industrial

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[16]Gerstenberg, op. cit., p. 4.

[17]Jackson Martindell, The Scientific Appraisal of Management (New York: Harper & Bros., 1950), p. 137.

III. According to nature of operation

A. Operating

B. Holding

C. Combination of A and B

IV. According to place of incorporation

A. Domestic

B. Foreign.[18]

Corporate Democracy

Where does the term "corporate democracy" come from and what is its implication? Lewis D. Gilbert[19] wrote: "May I blush and admit to being the author of 'corporate democracy'? I have used it constantly in my speeches, lectures, and at meetings." This can be safely said: The phrase has been in the making ever since Congress thrust on the Securities and Exchange Commission the responsibility of helping investors in financial clinches.

In 1943, Robert H. O'Brien, a member of the SEC, spoke of the need to "create an informed and active group of shareholders who have a voice in the councils of their own corporation." He talked about the "democratic process" in corporate affairs and the importance of good management-stockholder relations "in capitalism under democracy."[20]

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[18] William H. Husband and James C. Dockeray, Modern Corporation Finance (Homewood, Illinois: Richard D. Irwin, Inc., 1954), p. 20.

[19] Lewis D. Gilbert is a self-appointed Stockholder Vigilante Committee who is sui generis. He makes a career of being a professional stockholder by guarding his own and other stockholders' interests.

[20] Livingston, op. cit., p. 68.

With the issuance of common stock, a corporation assumes definite responsibilities and obligations to the holders of the stock. At the same time, it is essential to remember that the stockholders simply own the corporation; and the title to the property is lodged in the corporate name. Because of this breach between the shareholders and their ultimate property, it is necessary to provide them with sufficient rights and powers to afford adequate protection. This is achieved mainly through the following channels: (1) the power of stockholders to elect those in control; (2) the exercise of preemptive rights; and (3) the use of various other rights provided by law.[21]

Each stockholder has the fundamental right:

1. To a certificate showing his ownership of shares
2. To transfer ownership of his shares
3. To vote for directors
4. To vote on other questions affecting the corporation's property as a whole
5. To restrain _ultra vires_ acts of the corporation
6. To protect the corporation against wrongful acts of the directors
7. To inspect the books of the corporation
8. To receive dividends when they are declared
9. To subscribe in proportion to his holdings for any new issue of stock
10. To share in the proceeds of dissolution.[22]

Mrs. Wilma Soss[23] told the American Federation of Women Shareholders in Business, which she founded in her own image:

> We shareholders own the corporation. All these Prussian-faced dictators are just our employees -- laboring people, you might say. Naturally, we the owners have the right to give the hired help a few constructive suggestions from time to time.[24]

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[21] _Ibid._, p. 77.

[22] Gerstenberg, _op. cit._, pp. 107-108.

[23] Mrs. Soss is a professional press agent and a suffragette among American stockholders.

[24] Livingston, _op. cit._, p. 70.

One common purpose binds the advocates of corporate democracy together. They seek recognition from management. They want to be listened to; they want to feel that they have some say in the companies they own.[25]

It should be noted from the preceding paragraphs that the American stockholder does possess many rights of ownership which he may legally exercise. However, it should be remembered that the majority of investors in marketable securities are at best only superficially interested in the every-day operations of the corporation in which they have an equity and are predominantly concerned with the rate of return on their invested capital.

> The person who gets along in this world, who makes a success of his business or profession, is more interested in his own work, in what has made him a success, than in policing corporation executives and policies and safeguarding his legal rights as a stockholder. That implies that persons who in mass have much at stake as stockholders are least inclined to be legally exercised about it.[26]

At the risk of incurring the wrath of the advocates of "corporate democracy," it is only realistic to point out that although more and more managements are becoming cooperative, few corporation officers and directors recognize the majority of shareholders as true "owners" of the business.

> Corporations are not democracies. They are plutocracies. Democracy implies individual equality -- votes without distinction as to property. But in a corporation, each shareholder votes not as an individual, but in accord with his stake in the company. A holder of ten thousand shares has one hundred times the influence in electing directors as the holder of one hundred shares.[27]

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[25] *Ibid.*, p. 70.

[26] *Ibid.*, p. 26.

[27] *Ibid.*, p. 69.

The Stockholder -- Vital Statistics

Today, 12,490,000 people in this country own common stocks and there probably aren't more than ten of them who still wear plug hats, smoke two-dollar cigars and beat their liveried footmen. In contrast, of every one hundred stockholders in the country today, 55 of them earn $7,500 or less a year -- about nine of them having incomes of less than $58 a week, about twenty having incomes of $59 to $96 a week, and another twenty-six of them having incomes of $97 to $145 a week. Not quite forty-five of every 100 stockholders today can boast of incomes greater than $7,500 a year.[28]

Not until June, 1952, did Wall Street know how it stood on the job. Strange as it may seem, nobody could say how many stockholders there were in the country. American Telephone & Telegraph knew it had 1,200,000 stockholders and thirty other large companies knew they had more than 50,000 apiece. But nobody knew just what duplication there was in those stockholder lists. -- And nobody knew the grand total for all companies.

In that year, Keith Funston, president of the New York Stock Exchange, asked the Brookings Institution, a research organization of Washington, D. C., to find the facts. Brookings selected Lewis H. Kimmel, a careful research economist, for the job. After field studies and interviews with shareholders, Kimmel estimated the number of shareholders at 6,500,000.

At first, Wall Street was shocked and shrunken. The 6,500,000 estimate became a new credo, a goad to expansion, a promise to salesmen. It is the basis for the Exchange's Monthly Investment Plan -- MIP -- which permits people to buy

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[28]Engel, op. cit., p. 186.

stocks for as little as forty dollars every three months. The Stock Exchange had just begun to fight![29]

Although Kimmel's estimates are now out-of date, they are as comprehensive as any study to date and are quite purposeful to this report. Actually his statistics vary little from those findings of the Alfred Politz Research, Inc. survey announced in July, 1956. Politz at that time reported an increase of 33% in the number of shareholders in four years. This was due mainly to vigorous sales promotion and good times. Of course, today's figures indicate an increase of almost 50% from those reported by Kimmel in 1952.

Some of the key findings in the Politz survey reveal:

1. Women stockholders outnumber men by a margin of 51.6% to 48.4%, but men own a greater number of shares in the aggregate.

2. The typical stockholder is forty-eight years old.

3. Stock ownership is proportionately higher in New England than elsewhere.

4. College graduates account for only 8.2% of the population, but 29.2% of all stockholders. Those who went to college for one to three years make up 18.6% of the stockholders total, and those who got no further than high school account for 33.2%.

5. One out of every four business executives or proprietors own stock. For professional people the figure is one out of six.

6. Housewives and nonworking women account for 34.2% of all shareowners.[30]

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[29]Livingston, op. cit., p. 24.

[30]Engel, op. cit., p. 187.

The following four tables reflect some of the more significant results of Kimmel's survey.

TABLE 1

INDIVIDUAL SHARE OWNERS OF PUBLICLY OWNED STOCKS DISTRIBUTED BY INCOMES REPORTED FOR THEIR FAMILIES AS UNITS[a]

FAMILY INCOME	INDIVIDUAL SHAREOWNERS PER CENT OF TOTAL
Less than $2,000	4.3%
$2,000 to $3,000	5.4
$3,000 to $4,000	9.1
$4,000 to $5,000	12.8
$5,000 to $10,000	44.4
Over $10,000	24.0

[a]Lewis H. Kimmel, Share Ownership in the United States (Washington, D.C.: The Brookings Institution, 1952), p. 97.

TABLE 2

INDIVIDUAL SHARE OWNERS OF PUBLICLY OWNED STOCKS DISTRIBUTED BY EDUCATIONAL LEVEL[a]

Education	Individual Share Owners
8th grade or less	19.4%
1 to 3 years of high school	9.9
4 years of high school	29.0
1 to 3 years of college	20.9
4 or more years of college	20.5
Current students	0.3

[a]Lewis H. Kimmel, Share Ownership in the United States (Washington, D.C.: The Brookings Institution, 1952), p. 93.

TABLE 3

INDIVIDUAL SHARE OWNERS OF PUBLICLY OWNED STOCKS DISTRIBUTED BY AGE GROUPS[a]

Age Group	Individual Share Owners
Under 21 years	2.1%
21 to 29 years	6.0
30 to 39 years	18.2
40 to 49 years	19.9
50 to 59 years	27.0
60 years and over	26.8

[a]Lewis H. Kimmel, Share Ownership in the United States (Washington, D.C.: The Brookings Institution, 1952), p. 91.

TABLE 4

INDIVIDUAL SHARE OWNERS OF PUBLICLY OWNED STOCKS DISTRIBUTED BY OCCUPATIONAL GROUPS[a]

Occupation	Number of Shareholders	Per cent in Group Owning Stock
Executives	300,000	44.8%
Supervisors	620,000	19.4
Professional Persons	670,000	12.8
Salesmen	200,000	11.2
Merchants	250,000	10.6
Clerical Workers	590,000	7.6
Farmers	320,000	6.8
Skilled Workers - Foremen	410,000	4.4
Public Service Workers	40,000	3.4
Semi-skilled Workers	210,000	1.4
Unskilled	10,000	0.2
Members of Armed Forces[b]	20,000	1.1
Retired, Dependents	560,000	9.1
Housewives -- Nonemployed	2,130,000	6.0
Nonemployed Adults	30,000	1.3
Students & Pre-school Age	130,000	0.2

[a]Lewis H. Kimmel, Share Ownership in the United States (Washington, D.C.: The Brookings Institution, 1952), p. 98.

[b]Living in households as members of family.

The figures exhibited in the tables on the preceding pages, regardless of their age, are indicative of one thing:

> We may be the richest nation in the world, the very bulwark of a modern and enlightened capitalism, but the blunt fact of the matter is that we are as a nation financially illiterate.[31]

Whether the Marine officer be considered in the executive group on the basis of his operational duties or in the professional category on the basis of his individual characteristics, it seems safe to assume that he and his associates would comprise very little of the percentile accorded either of these groups depicted in Table 4.

Although it is recognized that the personal resources of the civilian members of these two groups would be substantially greater than their military counterparts, the financial aptitude should not vary commensurately. The results of the foregoing surveys seem to spotlight the need for this type of report.

The Need for More Investors

American business today needs more owners -- men and women willing to advance a portion of their savings to provide industry with the new ownership capital it must have in the years ahead in order to create jobs for those added each year to our working force, to produce new and improved products devised by industrial research, and to continue to raise the living standard of our increasing population.

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[31] Engel, op. cit., p. 187.

> A broader base of corporate ownership will provide all Americans with a better understanding of our capitalistic system, thus improving the internal political climate in which business operates and providing a bulwark against foreign ideologies.[32]

In response to Mr. Funston's plea, the New York Stock Exchange, in late 1959, conducted a study of the public's attitude toward and knowledge of the investing process. This study revealed the following information:

1. Broader shareownership is favored by 45 million adult Americans.

2. Thirty-five percent of the adult population -- and 52 percent of shareowners -- say they want more information about common stocks.

3. Twelve and eight-tenths million adults are "on the threshold" of investing and an additional 22.5 million are "interested" in specific investment techniques.

4. The fact that "you don't have to be rich to invest" has gained wide public acceptance.

5. While many people understand some of the advantages and disadvantages of owning stocks, only one adult out of four can adequately define common stock.

6. Millions of people feel they "don't know enough" and are reluctant to discuss their investment problems.[33]

As further evidence towards public receptivity to the cry for broader based American enterprise, the Wall Street Journal of March 10, 1961, released

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[32]G. Keith Funston, Wanted: More Owners of American Business (Boston: The Andover Press, Ltd., 1954), p. 42.

[33]The New York Stock Exchange, The Investors of Tomorrow, A public opinion survey (New York: The New York Stock Exchange, 1959(, p. 27.

this testimony:

> The feverish pace of trading on the New York Stock Exchange in recent weeks is pushing the exchange toward automation of many of its operations. . . . Current volume is outrunning all expectations of exchange officials. "We're now getting five-million-share days which our volume projections didn't anticipate until 1965," says G. Keith Funston, president of the Big Board.[34]

The Marine officer, through the function of investing, can play an important role in the entrepreneurship of the economy of the country he is dedicated to defend against all aggression.

> Our economy is the result of millions of decisions we all make every day about producing, earning, saving, investing and spending. Both our individual prosperity, and our nation's prosperity, rest directly on the decisions all of us are making now.[35]

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[34]The Wall Street Journal (New York), March 10, 1961, p. 1.

[35]Statement of Dwight D. Eisenhower, quoted in John Arthur Newmark (ed.), Wall Street 20th Century (New Haven, Conn.: Yale Daily News, 1960), p. 7.

CHAPTER II

THE MARINE OFFICER

As a member of the oldest branch of our armed forces, a corps consistently held in high esteem by the citizens of this country, the Marine officer is deemed to possess the professional integrity and the military capability exemplary of his position. Having laid a general foundation for this thesis in the preceding chapter, it is now proper to begin a discussion of this specific group of 16,065[1] professional men to whom this work is primarily directed.

The efforts of the following pages will be concentrated upon the personal financial affairs of the officer and the limitations imposed upon these matters by the peculiarities of his trade. These considerations will be discussed, for the most part, in generalities, and no reference will be made to the specific amount of funds to be placed in insurance, savings, real estate, or marketable securities. Moreover, because of a difference in background, experience, rank, and, therefore, income, no unqualified recommendation as to the management of funds can be made.

In the writer's opinion, if the education, occupational requirements and compensation of the Marine officer are set forth in these pages, the officer

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[1]U. S. Bureau of the Census, Statistical Abstract of the United States: 1960 (Washington, D.C.: U.S.Government Printing Office, 1960), p. 243.

should be able to place himself next to his equal in the stockholder category which was discussed in Chapter I. Estate planning is not the purpose of this thesis.

The Commission

"An officer is much more respected than any other man who has as little money."[2]

Upon being commissioned in the Armed Forces of the United States, a man incurs a lasting obligation to cherish and protect his country and to develop within himself that capacity and reserve strength which will enable him to serve its arms and the welfare of his fellow Americans with increasing wisdom, diligence, and patriotic conviction.

This is the meaning of his commission. It is not modified by any reason of assignment while in the service, nor is the obligation lessened on the day an officer puts the uniform aside and returns to civil life. Having been specially chosen by the United States to sustain the dignity and integrity of its sovereign power, an officer is expected so to maintain himself, and so to exert his influence for so long as he may live, that he will be recognized as a worthy symbol of all that is best in the national character.

Other than the officer corps, there is no group within our society toward which the obligation of the nation is more fully expressed. Even so, other Americans regard this fact with pride, rather than with envy. They accept the principle that some unusual advantage should attend exceptional and

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[2]Samuel Johnson, quoted in Rear Adm. A. A. Ageton, Col. R. D. Heinl, Jr. and Gen. C. C. Thomas, The Marine Officer's Guide (Menasha, Wisc.: George Banta Co., Inc., 1956), p. 208.

unremitting responsibility. Whatever path an American officer may walk, he enjoys prestige.

This national esteem for the officer corps is one of the priceless assets of American security. The services themselves so recognize it. That they place such strong emphasis upon the importance of personal honor among officers is because they know that the future of our arms and the well-being of our people depend upon a constant reviewing and strengthening of public faith in the virtue of the corps. Were this to languish, the nation would be loath to commit its sons to any military endeavor, no matter how grave the emergency.[3]

The Officer's Education

The Marine officer's education generally consists of at least four years of college study culminating in any one of a variety of baccalaureate degrees.

Regardless of the officer's major undertaking at college, he usually becomes acquainted with some of the precepts of investment at some point in his educational endeavors. It is a rare instance where a young man possessing a college background enters military life without an inkling of the facts of corporate enterprise.

To satisfy the requirements of substantially all the avenues to a career as a Marine officer, successful college graduation or the equivalent is necessary. Table 5 depicted below indicates the educational requirements which must be met by applicants for a Marine commission.

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[3] U. S. Department of Defense, The Armed Forces Officer (Washington, D.C.: U. S. Government Printing Office, 1950), pp. 1-2.

TABLE 5

AVENUES TO A CAREER IN THE MARINE CORPS[a]

Program or Source of Input	Educational Requirements	Leads To
U. S. Naval Academy	Graduation from USNA	2d Lt USMC
Naval ROTC (regular midshipman)	B.A. or B.S. degree	2d Lt USMC
Naval ROTC (contract student)	B.A. or B.S. degree	2d Lt USMCR
Platoon Leaders Class	B.A. or B.S. degree	2d Lt USMCR and USMC
Officer Candidate	B.A. or B.S. degree. Non-college graduates must pass a 4-year college equivalent examination	2d Lt USMCR
Naval Aviation Cadet	College students: must have satisfactorily completed 2 full years of college work at an accredited institution.	2d Lt USMCR
Warrant Officer	Professional examinations prescribed by the Commandant of the Marine Corps.	Warrant rank, USMC.

[a]Rear Adm. A. A. Ageton, Col. R. D. Heinl, Jr., and Gen. G. C. Thomas, The Marine Officer's Guide (Menasha, Wisc.: George Banta Co., Inc, 1956), pp. 208-209.

The Officer's Career Pattern

The Marine Officer's Guide offers sound advice to the young officer who is planning his career pattern. The authors state that a rounded career must be the goal, for it matures the individual and guarantees decision, judgment, steadiness, and practicality at the top. Raw materials for these attributes come in average quantity among most officers. But the extent to which he develops those qualities results largely from the kind of career he pursues.

Among the ingredients of a balanced Marine career are:

Experience in command

Professional Schooling

Combat experience

Staff experience

Sea and foreign shore duty.

The Marine officer's assignments send him to school, to sea, and to the Fleet Marine Force, and determine which of the thousand-and-one Marine jobs he will fill. Samples of typical assignment patterns may be found in Figure 1.

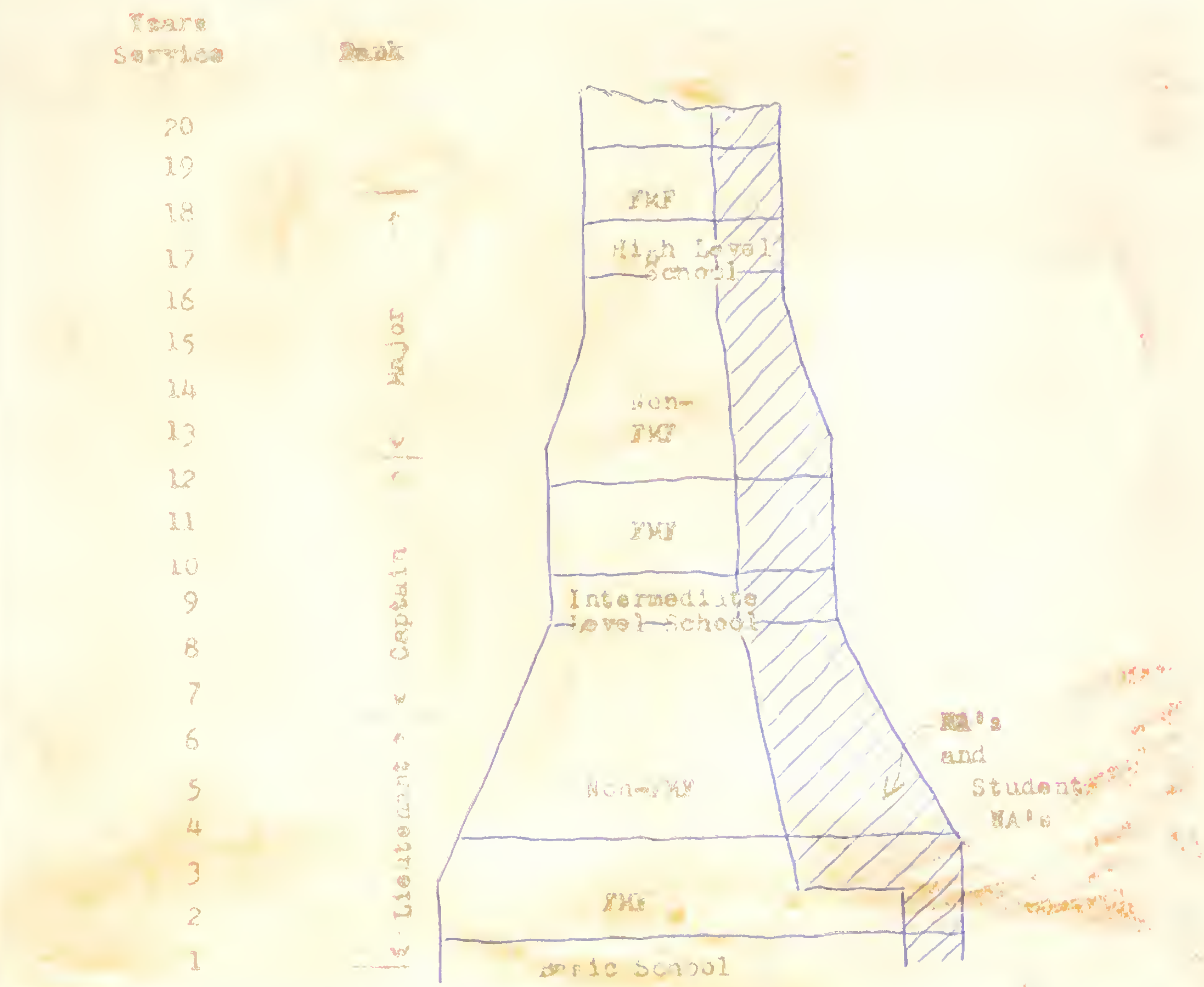
The following are examples of proper assignment patterns:

1. Officer W:

Lieutenant:	
Student, Basic School	7 months
Sea Duty Officer	1 year
Infantry Platoon Commander	1 year
Company Executive Officer	1 year
Battalion Staff Officer	6 months

FIGURE 1

TYPICAL ASSIGNMENT PATTERNS FOR GROUND AND AVIATION OFFICERS[a]



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[a]Rear Adm. A. A. Ageton, Col. R. D. Heinl, Jr., and Gen. G. C. Thomas, The Marine Officer's Guide (Menasha, Wisc.: George Banta Co., Inc., 1956), p. 281.

Captain:	
Marine Barracks Guard Company Commander	1 year
Marine Barracks Officer	1 year
Instructor, Basic School	2 years
Student, Junior Course, MCS	
Major:	
Battalion Operations Officer	2 years
Division Staff Officer	2 years
Officer-in-Charge, Marine Corps Recruiting Station/Inspector-Instructor	3 years

2. Officer X:

Lieutenant:	
Student, Basic School	7 months
Reconnaissance Platoon Commander	1 year
Regimental Staff Officer	1 year
Training Battalion Officer, MCRD	2 years
Captain:	
Officer Selection Officer/Inspector-Instructor	3 years
Infantry Company Commander	1 year
Student Junior Course	1 year
Major:	
Battalion Staff Officer	1-1/2 years
G-1 Division, HQMC	3 years
Student, Senior Course, MCS	1 year
Instructor, Junior Course, MCS	2 years

3. Officer Y:

Lieutenant:	
Student, Basic School	7 months
Artillery Battery Officer (includes associated Artillery Battery Officer Course)	1-1/2 years
Guided Missile Battalion (OJT)	1 year
Supply Duty	2 years

Captain:	
Supply Duty	1 year
Artillery Battery Commander	1 year
Battalion Staff Officer	1 year
Instructor, Field Artillery School, Fort Sill	3 years
Major:	
Barracks Commander	3 years
Command & Staff Course, Naval War College, Newport, R. I.	1 year
Joint or Combined Staff	2 years
Artillery Battalion Executive Officer	1 year

4. Officer Z:

Lieutenant:	
Student, Basic School	7 months
Flight Training	1-1/2 years
Tactical Squadron (includes overseas deployment)	2 years
Forward Air Controller	1 year
Captain:	
Instructor, Naval Training Command	2 years
Student Junior Course, MCS	1 year
Tactical Squadron	1-1/2 years
S-3 Section, Marine Corps Station	1-1/2 years
Major:	
Tactical Squadron (includes overseas deployment)	2-1/2 years
Senior Course	1 year
High Level Staff/Headquarters Marine Corps	3 years[4]

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[4]Information obtained from material prepared by personnel of the Officer Detail Branch, Headquarters U. S. Marine Corps, Washington, D. C.

The implications of the foregoing examples of career patterns are many. It is because of these exigencies that the military officer is unlike the majority of his civilian counterparts in the stockholder group.

The civilian shareowner or potential investor is invariably geographically situated within reasonable accessibility to an investment counsellor or stock broker. Because of this proximity he is able to keep abreast of the up-to-the-minute market fluctuations. He is usually cognizant of the political and industrial machinations which may affect the operations of the corporation in which he has an equity. Furthermore, the civilian investor's occupation is not migratory in nature and, hence, he is able to solidify relations with the broker of his choice. "The choice of the investment facilities to be used by the investor is a matter of prime importance."[5]

> The investment of money in securities is unique among business operations in that it is almost always based in some degree on advice received from others. The great bulk of investors are amateurs. Naturally they feel that in choosing their securities they can profit by professional guidance.[6]

Reassignment to a distant station is, of course, a day-to-day possibility in the life of any military officer.[7] Under the selection system of promotion, most officers retire between 45 and 60, and all must retire by the age of 62.[8] During the course of his twenty years of service within the

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[5]R. C. Effinger, ABC of Investing (New York & London: Harper & Bros., 1947), p. 9.

[6]Benjamin Graham, The Intelligent Investor (New York: Harper & Bros., 1954), p. 49.

[7]The Armed Forces Officer, p. 63.

[8]Ageton, Heinl, Jr., Thomas, op. cit., p. 431.

framework of a normal career pattern, the Marine officer would probably be situated in or near a large urban area only 30% of the time.[9]

Normally, every six years an assignment will take him outside of the continental United States. At present, the Third Marine Division and its supporting elements are located in Okinawa. Usually, seven of his twenty years of service will involve duty with the Fleet Marine Force. Stateside units constituting this force are situated primarily at Camp Lejeune (Second Marine Division), Cherry Point, North Carolina (Second Marine Air Wing), Camp Pendelton, California (First Marine Division), Marine Corps Air Station, Kaneohe Bay, Hawaii (First Marine Brigade), El Toro, California (Third Marine Air Wing). With the exception of the last two installations, brokerage facilities are not close at hand.

To many who are unfamiliar with Marine Corps assignment criteria, a non-Fleet Marine Force billet is usually associated with a recruiting assignment at a large metropolis or guard duty at a Naval shipyard. On the contrary, such a billet oftentimes is located at any of the Fleet Marine Force installations and the Marine still finds himself in rural surroundings.

For much of his career, the officer is isolated from business contacts and, because of transfer requirements, he rarely can become tied to a single investment advisor.

It should now be quite apparent that so far as concerning accessibility to the essentials of investment life and interpersonal relationships with the

[9]Information obtained from an interview with Major P D. La Fond, USMC, of the Officer Detail Branch, Headquarters U. S. Marine Corps, Washington, D. C.

sources of guidance, the Marine officer is at a disadvantage. And, because of these factors, his personal investment policies must lie within a framework which differs from that of the typical American stockholder.

The Officer's Income

The officer's compensation is based upon his rank and time in service. His pay rate is established by the Congress of the United States and is public knowledge. In most cases, the officer's salary is below civilian standards applicable to those individuals enjoying a status of equal responsibility and authority. To lessen this imbalance there is available to members of the armed services free medical care, discount-priced convenience goods, and tax-free subsistence and quarters allowances. Moreover, if the Marine officer attains the rank of major or higher he is eligible for retired pay after 20 years of satisfactory service. Tables 6, 7 and 8 reflect the officer's pay scale and retired pay at various ranks as fixed by Public Law 85-422.

The figures contained in the foregoing tables provide a monetary setting for discussion of the Marine officer's portfolio. It is highly impractical to attempt any determination of the amount of funds a typical officer may have available for investment in marketable securities. Estate planning in this chapter will be discussed only in generalities. In the opinion of some officers, $50 to $75 of monthly pay and allowances might reasonably be allocated to equity investment after funds have been withheld for maintaining living and social status.[10]

[10] Information obtained during interview with Marine Majors A. E. Hare and R. A. Deasy, Headquarters Battalion, Headquarters U. S. Marine Corps.

TABLE 6

MONTHLY BASIC PAY, ACTIVE DUTY (to nearest dollar)[a]

Pay Grade[b]	Under 2	Over 2	Over 3	Years in Service Over 4	Over 6	Over 8	Over 10	Over 12
0-10	$1200	$1250	$1250	$1250	$1250	$1300	$1300	$1400
0-9	1063	1100	1122	1122	1122	1150	1150	1200
0-8	963	1000	1022	1022	1022	1100	1100	1150
0-7	800	860	860	860	900	900	950	950
0-6	592	628	670	670	670	670	670	670
0-5	474	503	540	540	540	540	560	590
0-4	400	424	455	455	465	485	520	550
0-3	326	346	372	415	440	460	480	510
0-2	259	291	360	370	380	380	380	380
0-1	222	251	314	314	314	314	314	314

Pay Grade[b]	Over 14	Over 16	Over 18	Over 20	Over 22	Over 26	Over 30
0-10	$1400	$1500	$1500	$1600	$1600	$1700	$1700
0-9	1200	1300	1300	1400	1400	1500	1500
0-8	1150	1200	1250	1300	1350	1350	1350
0-7	1000	1100	1175	1175	1175	1175	1175
0-6	690	800	840	860	910	985	985
0-5	630	680	720	745	775	775	775
0-4	570	610	630	630	630	630	630
0-3	525	525	525	525	525	525	525
0-2	380	380	380	380	380	380	380
0-1	314	314	314	314	314	314	314

[a]Gordon R. Young, (ed.), The Army Almanac (Harrisburg, Pa.: The Stackpole Co., 1959), p. 151.

[b]0-1=Second Lieutenant
0-2=First Lieutenant
0-3=Captain
0-4=Major
0-5=Lieutenant Colonel
0-6=Colonel
0-7=Brigadier General
0-8=Major General
0-9=Lieutenant General
0-10=General (Commandant of the Marine Corps)

TABLE 7

QUARTERS ALLOWANCE (to nearest dollar)[a]

Pay Grade	With Dependents	Without Dependents
0-10	$171	$136
0-9	171	136
0-8	171	136
0-7	171	136
0-6	136	119
0-5	136	102
0-4	119	94
0-3	102	85
0-2	94	77
0-1	85	68

Note: Officers receive a subsistence allowance of $47.88 monthly.

[a]Gordon R. Young, (ed.), The Army Almanac (Harrisburg, Pa.: The Stackpole Co., 1959), p. 153.

TABLE 8

MONTHLY RETIRED PAY (to nearest dollar)[a]

Pay Grade	20 Years	30 Years
0-10	$800	$1275
0-9	700	1125
0-8	650	1012
0-7	587	881
0-6	430	738
0-5	372	581
0-4	315	472
0-3	262	393
0-2	190	285
0-1	157	235

Note: Monthly retired pay based on length of service or age is computed by multiplying the basic monthly pay of the grade in which retired by 2-1/2% times the years of service creditable for basic pay.

[a]Gordon R. Young, (ed.), The Army Almanac (Harrisburg, Pa.: The Stackpole Co., 1959), p. 157.

The Officer's Estate

The military officer should lose no time in laying the foundations of a balanced estate: an estate which reflects well-planned objectives; which is built on a prudent insurance program, wise investments, and property ownership; and which affords shockproof protection against the unexpected.[11]

For any officer with dependents, insurance is, of course, a necessity. How much it should be, and what its form, are matters for his judgment and conscience and according to his circumstances. A sound life-insurance program varies with income, age and number of children, the age of the insured and his probable number of years remaining upon the active employment list.

Periodically, the officer must overhaul his program, considering carefully the number of years his children will remain dependent, their educational requirements, his outside income, his wife's employment capabilities, his income after retirement, and any experience qualifying him for civil employment.[12]

By reason of his membership in the armed services of this country, the Marine officer and his family participate in the benefits offered by two forms of insurance-type programs. During the summer of 1956, the 84th Congress passed into law the Servicemen's and Veterans' Survivor Benefits Act (Public Law 881) which provides for broader benefits for survivors of military personnel who die in service or who die later as a result of military service.

Simply stated, the law provides (1) that a six-month death gratuity is paid to survivors by the service concerned as soon as possible after the

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[11] Ageton, Heinl, Jr., Thomas, op. cit., p. 431.

[12] Ibid., p. 432.

serviceman's death. The amount is computed as follows: total monthly pay x 6 = death gratuity (not to exceed $3,000); (2) compensation payable monthly to a serviceman's widow, the amount is related to the pay of the rank held by the serviceman at the time of his death computed as follows: $112 plus 12% of member's monthly basic pay; and (3) benefits for children under age 18 under Social Security eligibility.[13]

Established in 1879, under the auspices of the Secretary of the Navy as a nonprofit organization, the Navy Mutual Aid Association provides a guaranteed benefit of $7,500 plus a terminating dividend of $2,500 and an instantaneous dispatch of $1,000 to the survivors upon death of a Navy, Marine, or Coast Guard officer. The premiums for this type of insurance are comparably lower than for a similar type policy offered those individuals in civilian life.[14]

As could be expected, there is much speculation on the part of experts as to the types and amounts of insurance programs the military officer should participate in to supplement the aforementioned plans. In the writer's opinion, the majority of professional advice received by most officers is directed toward coverage which requires an excessive amount of his personal funds to be placed in insurance premiums -- under the pretense that insurance is a savings.

Short-term policies, ordinary life plans, endowment policies and family plans, and a combination of any of these are among the myriad of insurance programs followed by the military men.

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[13] U. S. Department of Defense, Protecting Your Family (Washington, D.C.: U. S. Government Printing Office, 1956).

[14] Ibid.

Table 9 depicts a suggested life insurance program for career officers.

TABLE 9

SUGGESTED LIFE INSURANCE PROGRAM FOR CAREER OFFICERS[a]

Grade	Age	Family Status	Base Pay	Recommended Insurance Amount
Ensign (0-1)	22	Unmarried-No children	$222	$17,500
Lt.(JG) (0-2)	26	Married-One child	370	27,500
Lt. (0-3)	29	Married-Two children	440	39,500
Lt. Cmdr. (0-4)	33	Married-Two children	520	49,500
Commander (0-5)	37	Married-Two children	630	49,500
Captain (0-6)	43	Married-Two children	860	49,500

[a]U. S. Navy Department, Suggested Life Insurance Program (Washington, D. C.: U. S. Government Printing Office, 1960).

Some officers find it financially advantageous to buy real estate where they have duty and are not assigned quarters, then to sell or rent when ordered to other shore duty, or else leave the family in their own home while on sea or expeditionary service. While absentee landlord is a difficult role, it is oftentimes worthwhile to the officer to have a home available when he returns, and he can approach retirement with something besides cancelled checks and rent receipts.[15]

[15]Ageton, Heinl, Jr., Thomas, op. cit., p. 436.

The habit of systematic saving is an essential form of career insurance for the military officer as it is for any working man. The officer who will not deprive himself of a few luxuries to build up a financial reserve for future contingencies is as reckless as the one who in battle commits his manpower reserve to front-line action without first weighing his situation.[16]

The officer must meticulously oversee his day-to-day living expenses to insure that he does not abuse credit extension and consequently seriously jeopardize his career and social standing.

> Concerning the evils of running into debt, there is hardly need for a sermon to any American male who has brains enough to memorize his general orders. As Mr. Micawber put it to David Copperfield, "The blossom is blighted, the leaf is withered, the god of days goes down upon the dreary scene, and -- and, in short, you are forever floored." The over-extension of credit is a not unknown American failing.[17]

<u>The Officer as an American Stockholder</u>

The Marine officer differs fundamentally from the typical stockholder of this country. His occupation is such that it requires dislocation at least every three years; the civilian's job rarely makes such a demand. The Marine officer seldom has easy access to reputable investment counselors or brokers; the civilian usually does. The Marine officer's occupational surroundings and his social environment make it difficult for him to keep abreast of the current state of the market and of business activity; the civilian's job is, as a rule, more conducive to this type of effort. Although his educational background is

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[16]The Armed Forces Officer, <u>op. cit</u>., p. 64.

[17]<u>Ibid</u>., p. 64.

favorably comparable (as a class) to the non-serviceman's, the military officer's income, generally is not.

This analysis tends clearly to one conclusion: if the Marine officer is to invest profitably in marketable securities, then he must be more than normally cognizant of essential investment criteria. Since he cannot depend upon finding constant reliable investment counsel, then he must be prepared to rely more upon himself. He is, in many respects, an atypical American stockholder.

PART II

THE GENERALITIES OF INVESTMENT

CHAPTER III

THE PRINCIPAL TYPES OF INVESTMENT

Although the primary objective of this paper is to acquaint the reader with the marketable securities area of investing, the purpose of this chapter is to briefly consider the field of investing in its broadest scope. "The successful investment of money requires that the investor understand the primary difference between the various classes of investments."[1]

Economic activity is undertaken for economic returns or rewards, the principal forms being (1) current income, (2) capital or realized gains and losses, (3) market value gains and losses, (4) purchasing power gains and losses, and (5) monetary gains and losses. The investor may use any or all of these concepts in measuring his economic success or failure, but the emphasis will vary among investors at any given time and will vary, in the case of a given investor, from time to time.

Income which flows currently and regularly in the form of salary, interest and dividends is recognized by all as a reward for services rendered or for the use of capital.[2]

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[1]Roger W. Babson, Investment Fundamentals (New York: Harper & Bros., 1935), p. 2.

[2]Dr. Paul L. Morrison, "Investment Management," Fundamentals of Investment Banking, ed. Julien H. Collins (New York: Prentice-Hall, Inc., 1949), p. 677.

> If we consider those who have capital funds to invest, we will not find all investors willing to use these funds for the same purposes. . . . At one extreme are investors who are interested solely in capital appreciation while at the opposite extreme are those investors principally interested in preserving their capital intact. Between these two extremes of risks there are many types of investors, each interested in varying degrees of risk and return on the funds they supply.[3]

It is quite obvious that all types of investment of capital funds must be dependent upon the availability of these funds. Without the existence of personal savings, investment of any sort would be greatly limited. The two primary sources of capital funds available to those providing the demand for the funds are (1) individual personal savings and (2) reinvested earnings of business corporations. The information discussed in this chapter is concerned with the first of these two.

While it is not necessary for the purposes of this report to study the determinants of personal saving or the causes that give rise to savings habits, it should be noted that personal saving fluctuates with changes in the national disposable income which, in turn, is closely related to the business cycle.

It can be further pointed out that savings habits differ among individuals, among income groups and between nations. And that, important factors in determining the volume of personal savings are (1) the distribution of personal income payments throughout the population, (2) the stability of national and local governments, (3) the stability of the currency system of the country, and (4) the tax structure presently in effect.[4]

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[3]Douglas Hamilton Bellemore, Investments, Principles, Practices and Analysis (New York: B. C. Forbes & Sons Publishing Co., Inc., 1953), p. 45.

[4]*Ibid.*, pp. 46-58.

Savings Deposits

The sage advice of Roger W. Babson offered almost thirty years ago is no less appropriate today:

> You may know how to select securities wisely, and you may have the most perfect type of investment program, but you get no real income or profits unless you have the cash to put this knowledge to work. The person, then, who has a real desire to reach the goal of investment success, and must rely upon his own initiative, should realize that his first step is the accumulation of a reserve in the form of a bank account, or its equivalent. . . . Through the bank account, one builds up a liquid reserve fund which is available for special opportunities.[5]

Savings-Bank Deposit

The savings-bank deposit is the record of funds turned over to savings banks which then use the funds thus acquired to purchase securities and mortgages for long-term investment.[6] Banks customarily pay interest on these deposits, the rate of which will vary with the different communities and also amongst institutions in the same community. As of the end of 1960, interest rates in savings banks ranged from 3 percent to 3-3/4 percent. Banks in the south and west usually pay from one-quarter to one-half of one percent higher interest rates than those in the north and east.

Almost all savings banks pay interest from the day of deposit to the end of an interest period (usually quarterly). Many savings banks pay interest retroactively to the start of an interest period on deposits made a few days (often up to 15 days) after the start of such period. Some savings banks also

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[5]Babson, op. cit., pp. 2-3.

[6]E. C. Harwood, How to Invest Wisely (Pittsfield, Mass.: The Ben Franklin Press, Inc., 1955), p. 14.

permit withdrawals made during the last three business days of an interest quarter without loss of interest for the quarter.

To attract savers, many more savings banks now pay interest to the exact date of withdrawal, at any time within the normal interest period.

TABLE 10

THE POWER OF COMPOUND INTEREST[a]

A regular investment of $100 per year invested at:	5 Years	10 Years	15 Years	20 Years	25 Years
2%	$530	$1,117	$1,764	$2,478	$3,267
3	546	1,181	1,916	2,767	3,755
4	563	1,248	2,082	3,096	4,331
5	580	1,321	2,266	3,472	5,011
6	598	1,397	2,467	3,899	5,816
7	615	1,478	2,689	4,387	6,767
8	634	1,565	2,932	4,942	7,895
9	652	1,656	3,200	5,576	9,232
10	671	1,753	3,495	6,300	10,818

Note: To get the corresponding total for any other annually invested amount (A), multiply the dollar total given above for the interest rate and number of years assumed by A/100.

[a]Leo Barnes, Your Investments (New York: American Research Council, Inc., 1961), p. 17.

Almost all savings banks carry Federal deposit insurance, under which individual accounts are insured for virtually immediate payment up to $10,000 by a permanent government agency, the Federal Deposit Insurance Corporation. An individual may have as many separate accounts of less than $10,000 as he wishes in different banks, and each will be insured.[7] Besides this direct guarantee, such insurance has the additional advantage that the insuring organization imposes rigid restrictions upon the management of each institution insured, and periodically conducts a thorough examination to determine that these regulations are being respected.[8]

An individual's agreement with a savings bank allows the bank to require advance notice (generally 60 days) of withdrawals. However, this requirement would be invoked only in extreme emergencies, since even a rumor that such notice was in force would cause a run on the bank.[9]

> This form of investment is essential if a man is going to protect himself properly against the always unpredictable emergencies of life.[10]

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[7]Barnes, op. cit., p. 106.

[8]Robert U. Cooper, Investments for Professional People (New York: The Macmillan Co., 1959), p. 88.

[9]Barnes, op. cit., p. 106.

[10]Louis Engel, How to Buy Stocks (Boston: Little, Brown & Co., 1953), p. 6.

Postal Savings

The United States Government has established the United States Postal Savings System, which is administered by the Post Office Department and accepts deposits in any post office in the country. Interest at the rate of 2 per cent per annum, calculated quarterly, starts to accrue on the first day of the month following the date of deposit. Principal and accumulated interest are guaranteed by the United States Government and may be withdrawn at any time by applying at the post office where the deposits were made.[11]

Among the less favorable features of the system are the upper limit of $2,500 per account and the fact that interest does not compound automatically but must be redeposited. Although better bank regulations, plus the insurance of deposits, has lessened the need for a postal savings system, it still attracts some four million depositors because of the maximum security afforded, and the easy accessibility.[12]

Savings and Loan Associations

Shares of federally insured savings and loan associations (also known as building and loan associations) are similar in many respects to savings deposits and appeal to persons who desire a somewhat greater rate of return than paid by banks. These associations, which are located throughout the United States (at present there are more than 6,200 of them), are private

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[11] Cooper, op. cit., p. 87.

[12] George W. Dowrie and Douglas R. Fuller, Investments (New York: John Wiley & Sons, Inc., 1950), p. 50.

organizations that invest most of their funds in regularly amortized high grade mortgages on real estate within 50 miles of the association's home office.[13]

Federally insured accounts, in either federal or state chartered associations, are a highly safe and liquid investment. What's more, investments in savings and loan associations provide the highest pretax yield of all continuously-guaranteed investments.

However, the insurance coverage of savings and loan shares operates differently from Federal deposit insurance for savings accounts. While the latter provides for repayment immediately or within a specified period after demand, Federal savings and loan insurance is not operative until the association involved has been declared in default by legal procedure. This could take a long period of time in some cases.[14]

It should be further noted that participation in ownership in these associations does not carry the unqualified right of withdrawal with it. To make a withdrawal of funds one surrenders his shares to the association; under unfavorable circumstances this may involve a considerable delay.[15]

There are two different type of accounts that may be opened at this type of association:

1. Savings share or pass-book account. This is the more popular type of account. Dividends are allowed to accumulate and compound at interest unless specifically requested to be mailed to the participant.

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[13] Harwood, op. cit., p. 15.

[14] Barnes, op. cit., p. 106.

[15] Dowrie & Fuller, op. cit., p. 51.

2. Investment share or certificate account. Here dividends are mailed to the participant unless he specified that they be retained. Certificates are often issued only in multiples of $100.

It should be remembered that not all savings and loan associations are federally insured and that, if associations in the reader's community are not now paying at least 4 per cent, there are many in other areas that are.[16]

In opening a savings account, or its equivalent, in a savings institution such as a bank, savings and loan association, or the postal savings department of the post office, the investor employs the institution as his investment intermediary. He is, therefore, freed from the necessity of selecting and supervising a list of securities or other media. Given proper management, supplemented by adequate public regulation, the savings institution will provide even depositors of trivial sums with adequate diversification and wise selection of risks.[17] Such an account is an excellent depository for funds while awaiting the most opportune moment to make other contemplated investments.

The chief disadvantages of such investments are that -- like all fixed-asset investments -- they do not provide adequate protection against dilution of the individual's purchasing power by inflation. Even a continuous guarantee of dollar principal does not insure purchasing power protection.[18]

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[16]Barnes, op. cit., p. 107.

[17]Dowrie & Fuller, op. cit., p. 49.

[18]Barnes, op. cit., p. 107.

Insurance

One of the more important investments for most individuals, particularly those of modest means, is insurance. At this point it should be mentioned that some doubt exists as to the propriety of considering insurance as a type of investment. It would seem more correct to view insurance as a supplement to investments.

To the extent that investments do not provide sufficient income for retirement or sufficient protection in the event of the death of the insured, insurance or annuities may be used. However, when investments can provide the necessary protection, insurance may be unnecessary; and continuation of insurance may involve a waste of assets.

Harwood distinguishes between insurance and investments, defining the former as "the pooling or sharing of risks by many persons so that the financial loss of one individual will be covered when the loss insured against occurs;" and the latter as "involving the assumption of risk by the individual himself, which can be done only when funds are sufficient for that purpose."[19]

Evans and Barnett further make the distinction that the payment of the future sum in insurance is conditioned upon the occurrence of a definite specified catastrophe while, of course, investment is not so conditioned.[20]

The breadwinner of a family may die or become disabled before he can accumulate a sufficient estate to enable his dependents to carry on without his earnings. To hedge against this risk, he should buy the maximum amount of life

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[19]Harwood, op. cit., p. 21.

[20]George Herberton Evans, Jr. and George E. Barnett, Principles of Investment (Boston: Houghton Mifflin Co., 1940), p. 2.

insurance consistent with the other important demands on his income.

The purpose of this discussion will be served sufficiently if three common types of insurance policies are briefly examined. First, what is known as the "straight life" policy requires the insured to pay a fixed annual premium up to the time of his death. If the policy is of the participating type, he will share in the annual dividends the company distributes as a result of having an excess of income over disbursements.

Second, the so-called endowment policy combines the hedge against an insured's death with systematic savings. If the insured has obtained, say, a $10,000 thirty-year endowment policy, his estate will receive $10,000 should his death occur at any time after the policy goes into effect. If he is still living at the expiration date of the 30 years, he may (a) receive the $10,000 in cash, (b) leave it at interest with the company, and (c) have it paid to him in installments.

Third, an annuity may be purchased under which an insurance company agrees to pay, say, to a husband and wife, a definite monthly income so long as either of them lives. If they live to a ripe old age the total amount they receive will be greatly in excess of the cost to the annuitants, but, if their deaths occur relatively soon, the return received will fall far short of the cost.[21]

Of late, combining life insurance with periodic investment plans is becoming increasingly popular. It is a way to insure that an individual's accumulation goal is reached, come what may. It is also a means for older

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[21] Dowrie & Fuller, op. cit., p. 52.

persons to get term insurance at moderate rates. Leading mutual funds like Axe-Houghton Fund B, Boston Fund, Putnam Fund of Boston, Wellington Fund and Pioneer Fund provide insurance features.[22]

With respect to what type of insurance it is best to buy, generalizations are unsafe. It would perhaps be best to terminate this section with the words of Roger Babson: "Life insurance has become a great social institution, a tower of strength in time of depression."[23]

Real Estate

Another medium for the investment of funds is real estate or real estate securities.

> From the earliest of times recorded in history, the ownership of land has been regarded as evidence of substantiality and prosperity. The intrinsic permanency of land exerts a strong appeal on the human race, since it provides the owner with a tangible asset which he can actually see and touch. The average man apparently has an inherent desire to own real estate, extending beyond the primitive wish to provide adequate shelter for himself and his family.
>
> Real estate ownership frequently results in the realization of substantial income or profits, occasionally even to a spectacular degree. On the other hand, many ventures in real estate prove decidedly unprofitable, generally because the original purchases were made at unwarranted or exorbitant prices. The inherent stability of land does not provide any guarantee against a decline in its worth in the open market nor does it prevent the gradual depreciation normally occurring in the buildings on the land.[24]

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[22] Barnes, op. cit., pp. 129-133.

[23] Babson, op. cit., p. 15.

[24] Cooper, op. cit., p. 98.

Real Estate Securities

Investors who do lend directly on property secured by mortgage, or who purchase mortgages already in existence, usually receive a higher rate of return than those who invest in other types of secured loans.

First mortgages can be obtained yielding 6 per cent to 8 per cent; second mortgages yield 10 per cent to 16 per cent and even more. Invariably, the higher the yield, the greater the risk.[25]

However, there are certain distinct disadvantages inherent in this type of investing medium. First, the mortgage has poor marketability if the investor finds it necessary to part with his investment. Second, a person who invests in mortgages must either assume all the numerous duties and responsibilities involved in looking after his loans or employ an agent to do it for him. Third, the purchase of a limited number of mortgages as an investment affords the investor scant diversification of risk. Fourth, the older type of mortgage is of short duration, running from one to five years; this necessitates its renewal at frequent intervals or a search for a new investment if the loan is repaid. Lastly, real estate investments are subject to the political manipulation of tax assessments and to legislative restrictions.[26]

Real Estate Syndicate

With the advent of the real estate syndicate, popularity in real estate investment has increased. This organization has highlighted the need for a way

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[25]Barnes, op. cit., p. 125.

[26]Dowrie and Fuller, op. cit., pp. 42-43.

of real estate investment in which the small investor could participate. These syndicates have been formed on a limited partnership tax basis in office and commercial buildings, apartment developments, bowling alleys, and shopping centers. They differ from the usual partnerships of professional real estate operators because of the participation in such syndicates of many nonprofessional investors.

They have grown rapidly as a result of such factors as tight money; the relative decline of the wealthy real estate investor; the shrinkage of yields on common stocks; the avoidance of the 52 per cent corporate income tax through use of the limited partnership form.

Successful real estate syndicates offer four big advantages:

1. Small investors can participate. While partnership shares occasionally run as low as $500, minimums of $1,000 or even $2,000 are more common.

2. Yields are usually larger than for stocks or bonds. Returns of 8 per cent to 15 per cent and more, usually paid monthly have been repeatedly achieved.

3. A substantial part of the return from real estate syndicates is free of federal and most state income taxes.

4. Long-term capital gain on the investment is quite probable.

Not all syndicates work out as favorably as the ideal pictured above. Here are some of the potential risks involved:

1. Loss of rentals can reduce, even eliminate, income in the future.

2. The marketability of shares in less successful syndicate deals is relatively poor.

3. Many syndicate deals are intricate and complex.

4. There has been a strong trend in recent years toward using the form of real estate syndications to finance what are essentially operating businesses -- like bowling alleys and motels -- instead of the traditional realty investment in office buildings, etc.

5. Outright fraud has occurred in a number of syndicate deals.[27]

In the final analysis, real estate may or may not be a good investment. This depends mainly upon three things: the fundamental situation and prospect for general business; the relative position of real estate in regard to other investments; and the position of the particular real estate investment under consideration.[28]

This type of investment should be left to those who have the time, skill, and facilities for giving to it the attention it requires and who are not likely to be embarrassed by its lack of marketability.

Government Bonds

> In formal legal terminology, a bond is a promissory note under seal. However, in the more familiar language of the street, it has been common to use the word "bond" to mean a long-term debt obligation, and particularly one issued to the general public.[29]

When an individual buys a share of stock, he is buying a share in a company. But when he buys a bond, he is only lending the company his money. The bond is the legal expression of that debt. Every bond states that the issuing company will repay the face value of the bond at the time specified and

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[27]Barnes, op. cit., pp. 123-124.

[28]Babson, op. cit., p. 77.

[29]William H. Husband and James C. Dockeray, Modern Corporation Finance (Homewood, Ill.: Richard D. Irwin, Inc., 1954), p. 101.

will pay interest at a specified rate until the debt is repaid.[30]

The obligations of the United States enjoy the highest possible investment rating with respect to safety, assured income, and freedom from care.[31]

There are five principal kinds of U. S. Treasury securities of interest to individuals and institutions. Arranged in declining order of maturity, they are:

1. U. S. Treasury bonds -- medium-term if the maturity is from five to ten years, long-term if over ten years.

2. U. S. Treasury notes -- mature in from one to five years.

3. U. S. Treasury certificates -- mature in a year or less.

4. U. S. Treasury bills -- mature in 91 or 182 days, are issued weekly, in bearer form only, on a discount basis.

5. U. S. Treasury tax anticipation bills and certificates -- issued to mature a few days after federal income tax payment dates. Prices of government bonds are typically quoted in 32nds (for example, a quote of 98.17 means 98 and 17/32) and in most cases are sold in denominations of $1,000.[32]

In periods of stock market uncertainty, or whenever stocks generally are overpriced, the investor has the problem of what to do with available investment funds. Savings must usually be kept in the bank through an interest payment date in order to receive interest. By contrast, Treasury bills are the nearest thing to cash, yet earn interest from the date of purchase to either

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[30] Barnes, op. cit., p. 101.

[31] Dowrie and Fuller, op. cit., p. 44.

[32] Barnes, op. cit., p. 101.

TABLE 11

U. S. GOVERNMENT BOND QUOTATIONS[a]
(EXCERPTS)

BONDS

Outstanding Millions	Rate	Maturities	Bid	Asked	% Yield
2,239	2-3/4s	Sept., '61	100.2	100.4	2.49
6,963	2-1/2s	Nov., '61	99.29	99.31	2.54
1,484	3s	Aug., '66	97.22	97.28	3.43
2,719	3-1/2s	Feb., '90	93.24	94.0	3.84
		BILLS			
1,601		Mar. 23	2.30%	2.00%	2.03
1,500		Mar. 30	2.20	2.00	2.03
1,501		Apr. 6	2.00	1.80	1.93
2,000		Apr. 15	2.15	2.00	2.03
		NOTES			
144	1-1/2	Apr., '61	99.30	99.31	2.20
4,078	3-5/8	May '61	100.5	100.6	2.23
2,136	4	Aug., '61	100.16	100.18	2.45
2,211	4	May '62	101.8	101.10	2.89

[a]*The New York Times*, March 21, 1961, p. 54.

the day of sale or the day of maturity. These bills can be bought or sold through a bank or broker.[33]

With the exception of the Treasury Bonds, the government securities listed are usually dealt in by the large banks and institutions and are not commonly contemplated by the individual investor of modest means.

Savings Bonds

Savings bonds, currently issued in only two series, E and H, can be bought only from the government and sold back at any time only to the government -- in both cases at prices exactly stipulated in advance. Almost any bank and many security brokers will sell these bonds without any commission or service charge.

These savings bonds are designed primarily to appeal to individuals who wish to place their savings at interest for period of from 8 to 10 years, but at the same time wish to have their principal instantly available without any possibility of loss if they decide they want to use their funds at any time during the period. The bonds are all issued in registered form, are non-transferable and cannot be used as collateral for loans.[34] The series E bond is available in denominations of $25, $50, $100, $200, $500, $1,000 and $10,000 and is sold at 25% discount. This type bond matures seven years and nine months from the first day of the month of purchase and is redeemable any time after sixty days from issue date. The bond may be held up to ten years after

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[33] Ibid., p. 101.

[34] Bellemore, op. cit., p. 493.

maturity and has attached a steeply graduated interest yield -- very small in the first few years, rising gradually to 3.75 per cent at maturity.

The series H bond is a larger denomination bond for investors who prefer to draw interest currently. The issue prices may be in terms of $500, $1,000, $5,000 and $10,000. The bonds are redeemable at par on the first day of any month after six months from month of issue and require one month's written notice of intent to redeem. The bond matures in ten years and yields in the form of semiannual interest payments graduated so that the return is very similar to that of E bonds.[35]

Although the redemption values and yields on the new U. S. Government savings bonds have been considerably improved, they can hardly be considered the most advantageous medium for the investment of funds needed before the bonds mature. Study of the graduated tables of redemption of bonds shows that bond yields prior to maturity still compare unfavorably with the yields from other available investments of similar quality.[36]

As short-term investments, savings bonds yields are far below those of savings and loan shares and slightly below those of some savings deposits.

Bond Yield Determination

Before discussing the tax-exempt type bonds, it would seem appropriate to explain the computation of a bond's yield. Because almost all bonds stipulate payment of a principal amount at some specific date in the future,

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[35]Barnes, op. cit., p. 109.

[36]Cooper, op. cit., p. 172.

the return (or yield) on bonds is computed in a somewhat different manner than that on stocks or other such investments.

Bonds traded in public markets ordinarily fluctuate above or below their face value. Bond prices are expressed as a percent of the face value of the bond. For example, a bond selling at 92 represents a price of $920 per $1,000 of face value, although the denomination purchased may be $100, $500, $1,000, etc.

Bonds selling below 100 are said to be selling at a discount; bonds selling above 100 are said to be selling at a premium. The total income return on bonds selling at a discount takes into consideration not only the annual cash return specified in the coupon rate of the bond but also the fact that at maturity the payment of principal will be greater than the purchase price. Conversely, for bonds selling at a premium, the payment at maturity will be less than the purchase price; and the income return is reduced correspondingly.

> For example, assume that a $1,000 5 per cent bond due in 20 years is selling at 90. The interest rate is 5 per cent; and the current yield, as it is called, is $50 (the annual interest payment) divided by $900 (the market price of the bond), or 5.55 per cent. However, at maturity the purchaser would receive $1,000 in payment of principal, $100 more than he paid for it 20 years earlier. By custom, this increase is averaged over the life of the bond and included as annual income over and above the interest received. The annual income return is thus $50 in interest plus an average annual increase of $5 ($100 divided by 20 years) in the value of the bond, or an annual average income of $55. The average value of the bond during the 20-year period would be $950 (midway between $900 at the time of purchase and $1,000 at maturity). An annual return of $55 is approximately 5.79 per cent on an investment of $950.[37]

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[37]Harwood, <u>op. cit</u>., p. 24.

Municipal Bonds

The fixed obligations of states and all lesser political subdivisions are customarily referred to as "municipal" bonds. They have the advantages of having their interest exempt from federal income taxes but, paradoxically, this feature makes them an unsuitable investment for most individuals. As with the tax-exempt U. S. Government bonds, the competitive bidding of institutions and wealthy persons, seeking an investment medium that will furnish tax-free income, boosts the market price of municipal bonds to a point where the yield will not appeal to the average investor.

There is one type of bond, frequently classified as a municipal, which currently bears an above-average rate of interest and that is the "revenue" bond, issued to finance the construction of arterial highways, bridges, and tunnels. The name is derived from the fact that payment of interest and principal is dependent upon the revenue obtained from tolls charged for public use of the facilities, instead of being guaranteed by the local political authorities. Most of the revenue bonds have proved so popular that they have been purchased in large blocks by insurance companies and institutions before being offered to individuals. The few bonds that eventually appear in the open market are generally priced considerably above par and consequently have lost much of their investment appeal.

Since there is a tendency for a large proportion of most municipal bond issues to be closely held in large blocks, the supply available for purchase is usually limited. As a consequence, they lack the ready marketability of bonds which are more actively traded, and there is frequently

a wide spread between their bid and ask quotations. The prices of these securities are not guaranteed but fluctuate with changes in basic interest rates and hence the holder of the bond cannot be sure of receiving his full principal back at any time.[38]

At the end of 1960, there were close to $70 billion outstanding tax-exempt municipal bonds -- with several billion in additional bonds approved by voters in the November elections.

There are five basic kinds of tax-exempt bonds presently on the market:

1. General obligation bonds (backed by the full taxing-power of the issuing body)

2. Revenue bonds (secured by expected revenue from particular projects)

3. Special assessment bonds (secured by special levies on taxpayers immediately benefiting from improvements)

4. Housing authority bonds (can be either general obligation bonds, revenue bonds, or a combination of both)

5. Industrial development bonds (issued by states to help finance the construction of privately-owned plants and facilities).[39]

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[38] Cooper, op. cit., p. 175.

[39] Barnes, op. cit., p. 110.

TABLE 12

MUNICIPAL OFFERINGS SCHEDULED (EXCERPTS)[a]

Issue	Amount	Probable Offering	Description	Principal Underwriters
Natrona County, Wyo.	$5,573,000	Monday	School	Competitive
Roxbury Township, N. J.	1,720,000	Monday	School	Competitive
New Mexico	2,000,000	Tuesday	Highway	Competitive
San Antonio, Texas	3,500,000	Thursday	Drainage	Competitive
Southern Ill. University	8,100,000	Thursday	Housing	Competitive

[a]Barron's (Boston), February 27, 1961, p. 24.

Corporate Securities

Corporate securities may be divided into two general classes: corporate bonds (commonly referred to as "industrials" in contradistinction to the government and municipals) representing indebtedness of the corporation and equity securities (common and preferred stock) representing ownership in the corporation.

In this section, corporate bonds and preferred stock (which possesses some bond characteristics) will be discussed, with an explanation of common stock being reserved for the final chapter of the paper.

Corporate Bonds

The bondholder is a creditor of the corporation and in return for the use of his capital the corporation promises him a fixed-interest payment that has priority over the claims of stockholders to dividends. The bondholder's claim usually is constant in dollar value and must be paid regularly by the company in order to avoid insolvency. Moreover, bonds usually have a maturity date when the principal sum is due. Because of the prior claim and the greater security of principal, bonds usually yield less than stocks.[40]

The more prominent features of the corporate bond may be listed as follows:

1. A definite promise to pay, as to principal amount
2. A definite promise to pay, as to interest
3. A definite life
4. A statement of the tender or medium of payment
5. The place of payment
6. Reference to the bond indenture for other rights and powers, such as limitations upon the issuance of additional securities, etc.[41]

In discussing corporate bonds one is confronted with so wide a variety of issues that only a few general comments can be made here.

The bonds of corporations are generally classified, according to the industry represented, into public utility, railroad, real estate, and industrial issues. The industrial group serves as a catch-all for all corporate bonds that

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[40]Harwood, op. cit., p. 22.

[41]Husband and Dockeray, op. cit., p. 102.

do not qualify for inclusion in any of the other three divisions.[42]

These obligations differ with respect to the nature of the legal security offered by the borrower. Much more important is the great difference in the financial strength of issuers. The type of business and the legal form of the obligation are significant only as they have a bearing on the ability and willingness of the company to meet its commitments to investors.[43]

In other words, while each of the above mentioned groups has its own peculiar investment merits, the advantages possessed by any given group are of less importance to the individual investor than the qualities of each separate security. The desirability of any particular bond for the individual should not be measured by whether it is a mortgage, collateral, or debenture (secured only by the general credit rating of the issuer) obligation. The unsecured debentures of a thriving industrial corporation, for example, may conceivably be a far more sound investment than the first mortgage bonds of a railroad which is barely earning its fixed charges.

Prior to investing in the bonds of a corporate enterprise the investor should seriously consider the following factors:

1. Adequacy of corporate earnings. The capability of the issuing corporation to operate profitably is the prime requisite in any bond appraisal. The soundness of a bond depends less on the valuation of any property pledge as security than on the ability of the issuer to earn enough money to insure regular payment of interest and redemption at maturity.

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[42] Cooper, *op. cit.*, p. 176.

[43] Dowrie and Fuller, *op.cit.*, p. 46.

2. Variations in Market Prices. The market value of a bond is vulnerable to the effects of any increases in the general rates of interest. Bonds of similar quality customarily sell at prices at which they will all produce approximately the same yield. When the prevailing interest rates (influenced by the Federal Reserve Board) advance, the fixed return of each bond forces its market price down to the level where its yield is commensurate with that of comparable issues.

3. Provisions of the Bond. When considering the purchase of bonds, it is generally advisable to read a synopsis of the chief provisions covering the issue. The presence of a provision requiring the regular accumulation of a sinking fund for the eventual redemption of the bonds or of a clause providing that they be retired serially at stated intervals, gives added stability to such securities. Another item to be noted is the price at which the bond may be called by the issuing corporation. This call price works to the disadvantage of the bondholder by setting a definite limit to the appreciation that may occur in the bond's market price.[44]

Excellent bond analysis is provided by such accepted statistical services as Standard & Poor, Moddy, and Fitch, and their manuals should be studied by every prospective purchaser of such securities.

> The high-grade bonds in a portfolio should serve as a backlog that will produce income dependably, even in time of depression and that is not likely to undergo a serious decline in market value. Since some degree of marketability is desirable, listed bonds or those with a good over-the-counter market are to be preferred to small unlisted issues. It cannot be repeated too often that the bond form should not lull the investor into a feeling of false security. If he foregoes the allurements of higher

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[44]Cooper, op. cit., pp. 176-182.

TABLE 13

WHAT BOND RATINGS MEAN[a]

	Moody's	Standard & Poor's
High-grade		
Gilt-edged	Aaa	AAA
High-quality	Aa	AA
Medium-grade		
Higher	A	A
Lower	Baa	BBB
Speculative		
Slightly	Ba	BB
Moderately	B	B
Very	(Caa	CCC)
	(Ca	CC)
Extremely	C	C

[a]Barnes, op. cit., p. 102.

> return and greater chance of appreciation associated with investment in equities, he is entitled to a high degree of safety.[45]

Funds invested in bonds share, with such fixed-value investments as life insurance and savings deposits, the danger that future inflation may dissipate some of their ultimate worth.

It is advisable for the professional man to restrict his bond purchases to the high-quality groups unless he has sufficient time and ability to thoroughly analyze the individual issues. Even then he should remember that the lower quality bonds constitute a precarious field of investment.[46]

> Bonds are fine investment, wonderfully marketable, fine collateral, safe and steady income producers. But they have their defects. They are static investments and offer no element of growth either in interest income or in principal value. Accordingly, they are not good investment vehicles for offsetting inflation and a shrinking dollar.[47]

TABLE 14

SELECTED SHORT-TERM BONDS MATURING IN 1962-1965[a]
(EXCERPTS)

Alum. Co. Amer. 3 1/8s '64 (A)
Boston & Albany 4 1/4s '63 (A)
Celanese Corp. 3s '65 (A)
Food Fair 3s '65 (BBB)
Koppers 3s '64 (AA)
Pennsylvania RR 4 1/2s '65 (BBB)
Texaco 3s '65 (AAA)

[a]Barnes, op. cit., p. 103.

[45]Dowrie and Fuller, op. cit., p. 47.

[46]Cooper, op. cit., p. 182.

[47]Ira U. Cobleigh, Guide to Success in the Stock Market (New York: Avon Book Division, The Hearst Corp., 1961), p. 31.

Preferred Stock

Although it bears the name "stock" rather than "bond," as an investment medium preferred stock possesses some bond characteristics. In fact, the relatively few high-grade preferred issues outstanding compare favorably with sound bonds as far as stability of income and safety of principal are concerned.[48]

Preferred stock is so-called because it is usually preferred over the common stock when dividends are paid. Dividends are such portion of the earnings of the corporation that the board of directors have in their sound discretion decided to distribute to the stockholders, after retaining a sufficient amount to provide for the future growth of the business and for other contingencies. Preferred stockholders will be paid their dividends out of earnings before the common stockholders receive anything.

Usually, preferred stock provides for a fixed return, for instance $6.00 per annum. Thus, if the corporation earns only enough to pay a $4.00 dividend on each share of preferred stock, the common stock, which has only a junior claim to the earnings, will receive nothing. However, if the company earns in excess of $6.00 for each share of preferred stock -- say $15.00 per share -- the preferred stock will nevertheless only receive $6.00, and the remaining $9.00 will go to the common stockholders.[49]

It has frequently been stated, with some justification, that the owners of preferred stock suffer all the handicaps of bondholders without enjoying any of their advantages. For instance, they have a similar limitation on the amount

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[48]Dowrie and Fuller, op. cit., p. 47.

[49]Stanley L. Kaufman, Practical and Legal Manual for the Investor (New York: Oceana Publications, 1956), pp. 11-12.

of corporation earnings to which they are entitled, although this yield is ordinarily somewhat higher than that of bonds of the same organization. In addition, they usually share with bondholders the disadvantage of having no voice in the control of management.[50]

The chief disabilities suffered by the preferred stock as contrasted with the bond are: (1) the payment of interest is mandatory while the preferred dividend may be passed with impunity, except in rare cases where the contract limits such freedom of action; (2) in cases of reorganization or liquidation, particularly where there are bonds outstanding also, preferred shareholders are in a relatively unfavorable bargaining position.[51]

Despite these apparent disadvantages, there are many issues of preferred stock which make excellent conservative investments, some of them having records of regular divident payments over many years without a single lapse. In cases where the available net earnings have consistently authorized the full payments of preferred dividends, the holders of this stock need be little disturbed by the legal circumscriptions of their position.

As in the appraisal of bonds, the most important consideration in determining the merit of a particular issue of preferred stock is the adequacy and consistency of the corporations' earnings.[52]

To offset some of the inherent disadvantages of this type of equity, additional features have often been added to plain preferred stocks to make them

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[50] Cooper, op. cit., p. 184.

[51] Dowrie and Fuller, op. cit., p. 47.

[52] Cooper, op. cit., pp. 185-186.

more enticing to investors. This has resulted in the following improvements or protective features for preferred stocks:

1. Cumulative preferred stocks. This is the basic protection for preferred stockholders. Most cumulative preferreds are fully cumulative. Dividends not paid in one year accumulate and must be made up in full before any distributions can be paid to the common stockholders.

2. Debt-free preferred stocks. Other factors being roughly equal, the preferred stock of a debt-free company is usually more attractive than the preferred of a company loaded with bonds or other long-term debt.

3. Preferred stocks with sinking funds. Here the company is required to set up an annual purchase fund to retire a stated percentage of the outstanding preferred stock at specified times at a specified price.

4. Noncallable preferred stocks. Most preferred stocks can be called by the issuing company when it is to its advantage to do so. However, there are a number of preferred stocks available that are noncallable. They can thus be held by stockholders as long as desired.

5. Participating preferred stocks. Instead of having all the extra earnings go to higher dividends on the common, a participating preferred shares in any additional earnings over a specified amount per common share, typically on a 50-50 basis.

6. Guaranteed stocks. Here dividends are guaranteed by another corporation.

7. Convertible preferred stocks. These are exchangeable at the owner's option into a specified number of shares of the related common stock at a

stipulated price. This feature permits a preferred to participate in the capital gains potential of the related common.[53]

In discussing the investment medium of preferred stocks, if the writer seemed somewhat pessimistic, the intention has been not to disparage their merit but rather to place the investor on his guard. Many preferred stocks constitute good investments but care is needed in their selection. Probably a good rule of thumb to follow is to always consider preferreds with special protective or participating features. Buy a plain preferred stock only when it is an overwhelming bargain -- when its yield is exceptionally high but when its dividend is still covered at least several times by prospective future earnings as well as current earnings.

The basic attraction of a preferred stock -- its yield advantage of 1 per cent or more over a comparable quality bond -- is not enough of itself to offset the negative factors described above.

Final Analysis

Although somewhat outdated at present, figures published by the Federal Reserve Bulletin, July, 1953 provide some insight into public participation in the various types of investments which have been described.

In the final analysis, it would seem unlikely that many of the investments discussed herein would appropriately suit the portfolio of a Marine officer. To be sure, he must possess insurance to supplement the protection afforded him by federal litigation.[54] The point to be made here is that

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[53]Barnes, _op. cit_., pp. 92-93.

[54]_Supra_, pp. 43-44.

TABLE 15

NONCONVERTIBLE PREFERRED STOCKS WITH SPECIAL PROTECTIVE FEATURES[a]
(EXCERPTS)

A. Fully Cumulative Preferreds with Sinking Funds.

Issue	Approximate Yield
Allied Stores 4%	4.8
American Waterworks 6%	5.4
Bell and Howell 4-1/4%	4.6
Bigelow-Sanford 4-1/2%	6.2
Carrier 4-1/2%	5.4
Ekco Products 4-1/2%	4.8
Phillip Morris 4%	4.8
Tidewater Oil $1.20	5.3
Westinghouse Electric 3.80%	4.4
Wilson $4.25	5.1

B. Fully Cumulative Preferreds that are Noncallable.

Issue	Approximate Yield
American Can 7%	4.6
Bethlehem Steel 7%	4.6
Case, J. I. $7	4.6
Liggett & Myers 7%	4.7
National Biscuit 7%	4.5
Quaker Oats 6%	4.5
U. S. Gypsum 7%	4.4
U. S. Steel 7%	4.7

[a]Barnes, op. cit., p. 93.

TABLE 16

SELECTED CONVERTIBLE PREFERRED STOCKS[a]
(As of September 1, 1960)

Issue & Div. Rate	No. Common Shares per PFD	Current PFD Call Price
American Airlines $3.50	4.83	102
American Cyanimid $3.50	4.00	109
Beatrice Foods $3.37-1/2	4.97	104-1/2
Schering $1.50	0.60	31-1/2
Safeway Stores $4.30	6.52	102
Dodge Mfg. $1.56	1.00	32-1/8
Lone Star Gas $4.84	3.00	105
Collins Radio $2.00	1.695	50-1/2
Celanese $4.50	2.273	105

[a]Barnes, op. cit., p. 98.

TABLE 17

REASONS FOR INVESTMENT PREFERENCE
WITHIN INCOME GROUPS[a]

(Percentage Distribution of Spending Units)

Preferred Investment and Reason for Preference	1952 Money Income Before Taxes		
	$3,000 and over	$3,000-$4,999	$5,000 and over
Savings Bonds:			
Safety	28	30	25
High Yield	14	16	12
Liquidity	2	3	2
Lack of Liquidity	2	1	2
Patriotism	9	10	8
Saving by Payroll Deduction	1	1	1
Other	4	4	3
Savings Accounts:			
Safety	7	7	7
High Yield	3	4	3
Liquidity	8	7	9
Other	4	4	3
Common Stock:			
High Yield	6	5	8
Hedge Against Inflation	3	1	6
Other	4	3	5
Real Estate:			
Safety	2	2	4
High Yield	5	5	6
Hedge against inflation	3	2	5
Tangible Investment	5	4	5
Other	6	5	7
Preference or Reasons for Preference Not Ascertained	10	12	8
Number of Cases	1729	906	823

[a]Bellemore, op. cit., p. 63.

excessive insurance should be avoided. In most instances, the officer probably also maintains a savings account with a bank to provide for contingencies. The validity of this investment is a moot point; for most any type of corrective action prompted by an unforeseen occurrence is provided by government service. Perhaps a minimum amount of funds invested in a savings deposit might be appropriate to provide against those few emergencies which might fall out of government cognizance.

Many officers purchase government savings bonds on a payroll deduction plan. As a form of automatic investment this may be beneficial, but it is doubtful that such an investment is financially sound in the present inflationary period. In fact, with interest rates as they are, deposits in a savings bank would probably provide a greater return.

The officer's investment in real estate is probably limited to placing funds in property which, eventually, he will personally use. Real estate investment, as previously described, requires much time, effort and technical skill and it is doubtful if the return on principal justifies the effort involved. In view of the requirements of his career pattern, the Marine officer would seldom have the opportunity to keep abreast of the real estate market.

Investment in the bond market requires a large amount of capital which the typical Marine officer does not possess. This notwithstanding, it would seem that current bond yields are not high enough to provide a hedge against inflation and are generally unattractive as an investment.

Preferred stocks require venture capital and, in this sense, compare unfavorably to an investment in common shares. If the Marine officer is disposed to investment in equity securities, his course of action should be investment in

the more dynamic medium -- common stocks. If risk is to be involved, the return should justify it.

CHAPTER IV

THE INDIVIDUAL'S PROGRAM

More than one commentator has marvelled at the casualness with which an investor will put his hard-earned savings into securities chosen at random on the basis of hearsay evidence or of high-pressure salesmanship, with only the haziest knowledge of the risks involved and with no pretense of following an orderly program. It is fair to say that the average investor does not feel that he needs or can spare for the management of his savings more than a small fraction of the effort and planning that went into their accumulation. In part, this attitude is the product of a naively cheerful overestimation of the ease of discovering favorable investment opportunities. In larger part, however, it probably results from lack of time, associated with an understandable stress on the primary importance of the individual's function of "earning a living."

In this haphazard approach to investment is found much of the explanation for the notorious lack of success of the average small investor. An adequate realization of the nature and ramifications of the problem and a systematic, planned attack upon it are half the battle of investment.[1]

Every investment should be made in conformity with a well-conceived investment program, with a view to attaining sound investment objectives, and

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[1]George W. Dowrie and Douglas R. Fuller, Investments (New York: John Wiley and Sons, Inc., 1950), p. 93.

with the intelligent choice of available facilities best suited to the investor's needs.

This sounds formidable, and may be made so, but need not necessarily be so. Every investor has at least some vague idea as to how he wishes to invest his money, what he hopes to accomplish by so doing, and what investment facilities are at his disposal. To the extent these ideas are not clearly defined, the investor is urged to take the time to state them clearly, consider their merits carefully, and, after amending them so as to reflect a realistic and reasonable approach to the problem of investing, use them as the basis for his investment program.[2]

Ideally conceived, the investment program of each investor should fit like a custom-made suit, with no two alike because of differences in pertinent facts. There are no dogmatic formulas through which the question can be solved satisfactorily for every individual. Each investor has his own peculiar situation.[3]

Accordingly, the writer would consider it improper -- and impertinent -- to postulate an ideal investment program for all Marine officers. It is within the proper province of this report, however, to discuss the fundamental considerations applicable to the subject. If the investor accords due weight to each of these considerations, the resultant program should prove satisfactory.

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[2]R. C. Effinger, ABC of Investing (New York: Harper & Bros., 1947), p. 3.

[3]Robert U. Cooper, Investments for Professional People (New York: The Macmillan Company, 1959), p. 293.

Investors -- and their objectives -- can be classed as (1) conservative, (2) enterprising, and (3) speculative. Different terms are sometimes used for (1) and (2) -- for instance, defensive and aggressive. Some people prefer to separate investment and speculation completely. For them, there are only two terms: investor and speculator.

How the words are chosen is not too important. What is essential is to recognize the facts that (1) there are these three approaches to buying and selling securities and other assets, (2) the dividing lines among them are not sharp and absolute, and (3) one may, if he so decides, combine two or even three of these approaches.

What makes each approach distinctive is the amount of safety that is demanded and the amount of risk that is permitted. However, the reader must recognize that safety and risk can only be estimated. A supposedly safe investment will often turn out more poorly than a "businessman's risk" or a rank speculation.

Accepting this limitation, the conservative investor stresses safety above all. He aims first to preserve his capital; and second, to earn a moderate, safe, and stable return on it. He will usually buy a security and hold it for a long time. The enterprising investor is ready to take more risks, and to buy and sell more frequently, for the chance of worthwhile capital growth and more generous income. The speculative investor will take the most risks, and buy and sell most frequently, in order to achieve maximum capital gains and maximum income.

Many investors will wish to be both conservative and enterprising. It is often feasible for one to divide his investment fund into two parts, one to

be managed conservatively, the other more aggressively. For instance, the investor may decide that he has the time to watch and manage his conservative investments, but neither the time nor ability to operate more aggressively. In this case, it would be to his advantage to turn over the aggressive part of his fund to a mutual fund (see Chapter VII).

Prerequisites

An individual's investment targets can most conveniently be grouped in line with the three investment approaches given above. The conservative approach demands:

1. Preservation of capital. This means not only conserving the actual number of dollars in the investment fund, but also -- and more important -- protecting the buying power of that fund over the years. Only in this way can the investor avoid being pauperized by either inflation or deflation.

2. Safe present and future income. These should be slightly better than the individual can get by putting his money in a savings bank or savings and loan association.

Under the category of the enterprising approach:

1. Growth of real capital. Not only should the investor's capital expand in step with inflation and the rise in the cost of living, but it should also grow in purchasing power at least as fast as the real growth in the nation's economy -- and preferably faster.

2. Maximum present income. This should be much higher than the individual can get in a savings bank or savings and loan association.

3. Rising future income. The investor may wish to give up part, even most, of possible current income in favor of a high income return three, five, ten, or more years from now -- to make up for anticipated declines in non-investment income, or to take advantage of lower tax rates available to older persons.

The speculative approach is based upon:

Maximum speculative gain. This implies rapid turnover of the investor's capital and prompt reinvestment of profits to achieve large income and repeated capital gains through all phases of business and market cycles.

In determining how conservative, enterprising, or speculative his program should be, the investor must evaluate the following factors:

1. Age and family status. A family man can afford to take fewer chances than a bachelor or a childless widower. A man with young children will usually have more conservative investment objectives than an older man with married children.

> The investment program should recognize the current needs and potential future requirements of every member of the family circle.[4]

2. Size of future responsibilities. If the individual has a home or a college and professional career for his son or daughter still to finance, his future income needs must receive first consideration. But if most of his large capital expenditures are behind him, his investment attitude can be more aggressive or speculative.

3. Current and anticipated income, savings and wealth. A worker earning $5,000 per year will have quite different investment objectives from an

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[4]Ibid., p. 297.

executive running his own business. The investor's pension and profit-sharing fund prospects, if any, should also be considered, as well as any expected future bequests or legacies.

> The net amount of money likely to be periodically available for investments may be readily estimated by keeping reasonably accurate records of the customary receipts and expenses over a representative period of time.[5]

4. Insurance status. The investor should weigh the amount and adequacy of his life, health, and disability insurance before deciding how much he has available for investment now or how much he will have in the future.

> The full impact of this advice cannot be appreciated by those who have not witnessed great numbers of tragedies resulting from failure to provide adequate insurance, or who have not found repeatedly upon the death of reputedly well-to-do men, that a relatively small amount of funds representing the proceeds from insurance constituted the greater part of their estates.[6]

5. Tax position. If the individual's income or wealth puts him in the higher tax brackets, he may be almost exclusively interested in capital gain rather than current or future income. On the other hand, if he is in the lower tax brackets, common stocks with good yields will usually be attractive, just because they often sell at lower prices than they would if high-tax bracket investors were more interested in them.

> The private investor in the United States must face two kinds of taxation on his investments -- that imposed by the Federal Government and that laid by the state and local authorities under which he lives. It is the joint effect of both that must be considered by the private investor in comparing the yield on taxable securities with that from partially or wholly tax-free investments. . . . Gains from the sale of property or securities are taxed as income.

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[5]*Ibid.*, p. 296.

[6]Effinger, *op. cit.*, p. 4.

> Against such gains the individual investor may, in general, offset losses. Gains and losses are classified into two groups, short-term and long-term. The former applies to assets held not more than eighteen months (taxed 100 percent); the latter applies to (a) assets held for more than eighteen months but not for more than twenty-four months (taxed 66 2/3 per cent), and (b) assets held for more than twenty-four months (taxed 50 per cent).[7]

6. Personality and "philosophy of life." If the investor is a chronic worrier -- if he trembles at the thought of even temporary losses -- he would do well to avoid highly speculative investments. If he is more of a risk-taker by disposition, he will be more interested in the more speculative securities.

> The planning of an investment program should commence with some measure of self-analysis. Each of us has distinctive traits of personality and it is generally easier to develop a program to fit them than to alter our personalites to accommodate our investments. . . . Each individual should candidly analyze his normal investment tendencies and respect them when planning his program. If he believes that his natural tendencies are too conservative, he should experiment with an occasional investment of the more speculative type. If he feels that he is inclined to be too venturesome for his own financial security, he may school himself to keep a fixed proportion of his savings in the more conservative fields.[8]

> Anxiety reduces dividends. The only worthwhile objective is the attainment of serenity. Making profits and building appreciation or income can contribute to this end only if the effort and anxiety involved do not erode your peace of mind. . . . By and large an investor's peace of mind seems to be determined by an equation in which the terms represent economic and psychological factors. Such an equation might be written:
>
> $$\$ + P = \text{Serenity}$$
>
> where \$ stands for all the economic factors involved for the particular investor and P stands for the whole group of psychological factors.[9]

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[7]George Evans, Jr. and George E. Barnett, Principles of Investment (Boston: Houghton Mifflin Co., 1940), p. 129.

[8]Cooper, op. cit., pp. 294-295.

[9]Linhart Stearns, How to Live with Your Investments (New York: Simon & Schuster, 1955), pp. 12-13.

7. Time. The less of it the individual has to devote to his investments, the more conservative his investment selections should be. But one should recognize that time invested in personal investment research and analysis will almost always pay off in higher income and capital growth. In many cases, it is definitely false economy for an individual to say he can't spare the time from business to devote to his investments.

8. Willingness to let others handle the portfolio. If the investor is ready to permit outsiders to direct and supervise his investments, his choice of investment targets will usually be wider than if he does it himself.

9. Knowledge of investment markets and investment techniques. The wider the individual's knowledge of investment opportunities and investment techniques, the more precise his investment objectives are likely to be. They are also apt to be more aggressive -- even speculative.[10]

Basic Investment Principles

Certain fundamental principles should be considered in appraising the investment position of each individual. These guides pertain to the principal and income of the investor's fund and are the determining factors in the allocation of funds and the selection of types of securities suitable for his particular program.

Security of principal in an absolute sense means that the investor's commitment would be secure at all times and in no danger whatsoever of being impaired in dollar value; it implies that the investor would be certain to have

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[10]Leo Barnes, Your Investments (New York: American Research Council, Inc., 1961), pp. 7-9.

FIGURE 2

A SIMPLE WAY TO LINE UP INVESTMENT TARGETS[a]

My Investment Goals	Rank in order of importance	I Plan to Invest in	Amount	% of Total Present Fund
Conservative		Conservative investments	\$.....	......%
1. Preservation of capital	....	Enterprising investments	\$.....	......%
2. Safe present and future income (I need \$....... per year)	....	Speculative investments	\$.....	......%
		Total	\$.....	......100%
Enterprising				
3. Growth of real capital (My goal is \$........)	....	I shall handle my own	\$.....	......%
		I shall let others handle for me	\$.....	......%
4. Maximum present income (I need \$..... per year)	....	Total	\$.....	......100%
5. Rising future income (I need by 19__, \$..... per year)	....	I can devote .... hours per week to supervising my investments.		
Speculative				
6. Maximum speculative gain (My target is ....% per year)	....	My top tax bracket is about ....%		

[a]Barnes, op. cit., p. 8.

his funds returned intact whenever he so desired. However, such absolute safety is unattainable. Consequently, the investor seeking preservation of the dollar amounts of his securities must understand that investment in even the highest quality of contractual obligations involves some element of risk.

Stability of income refers to the regularity of income in specific dollar amounts from an investment. Because the market value of an investment in an enterprise ultimately depends upon the ability of that enterprise to earn money, the income stability of an investment is related closely to its safety of principal. Relative stability in the rate of dollar income may best be obtained by holding various types of fixed-income investments discussed in Chapter III. Some common stocks, although not contractually guaranteeing a fixed income, have yielded a relatively stable income in dividends for extended periods.

Appreciation of capital may be obtained when the market value of an investment increases to more than the purchase price. Common stocks as a class offer greater potentialities of appreciation than bonds, and lower-grade bonds may increase in value more than the higher-grade bonds. Certain industries and companies may benefit during periods of inflation. Price appreciation resulting from owning shares of these companies during inflationary booms will help the investor to counterbalance the decreased purchasing power of his fund.

Marketability pertains to the facility with which a security can be bought and sold. Good marketability implies an accessible market where purchase or sale can be made quickly. Investments vary widely as to this attribute; but good marketability is most often found in securities that are traded on one of the large securities exchanges, that are widely held by

investors throughout the country, and that are part of a large issue of a security in the hands of investors.

<u>Diversification</u> is an important investment principle, because the investor thereby reduces the risk of large losses. Diversification does not eliminate loss; it merely confines a particular type of loss to a portion of the total fund. Diversification may be accomplished simply by investing in a large number of different companies. However, in order to obtain the maximum degree of protection, the investor should take advantage of at least five distinct types of diversification: (1) according to types of securities (stocks as protection against inflation; bonds for stability of real income); (2) by industry; (3) among companies; (4) by geographic location; and according to maturity dates of bond issues.[11]

Securities and Objectives

There is no single security, group or class of securities which will provide price stability, continuity of income, a relatively high rate of income and opportunity for capital appreciation. But all of these objectives may be properly sought by allocating separate parts of an investment fund to the accomplishment of each of these objectives.

R. C. Effinger recommends the groups and classes of securities which will best serve the different types of investment objectives:

1. <u>For price stability</u> -- high-grade, short-term bonds and notes.

High investment quality, as evidenced by the ability of the borrower to meet debt service costs by a wide margin of safety, is important because only

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[11] E. C. Harwood, <u>How to Invest Wisely</u> (Pittsfield, Mass.: The Ben Franklin Press, Inc., 1955), pp. 35-38.

obligations so rated give maximum assurance of price stability and prompt payment of principal at maturity.

Short maturity is important for price stability even in the case of highest-grade bonds because for any given increase in interest rates, the shorter the maturity, the less the decline in price.

2. For continuity of income, safety of principal and relative price stability -- high-grade, long-term bonds.

Because of their relatively narrow price fluctuations, high-grade, long-term bonds may properly be purchased at any time. Few persons think of high-grade bonds as ever being really cheap. They are, however, when security prices generally are high because at such times their prices are materially less inflated in comparison with more price volatile securities.

The ideal in a high-grade, long-term corporate bond is to be found in one that is protected both by a wide margin in earnings over the amount required to cover interest and other fixed charges.

3. For a relatively high rate of income -- good-grade, long-term bonds; preferred stocks of high quality.

The earmarks of good-grade, as distinct from high-grade, bonds are: a good rate of fixed-charge coverage and no lien on specific assets; or a good mortgage position with only fair fixed-charge coverage; or a combination of fixed-charge coverage and mortgage position that is satisfactory but below that required for a high investment rating. The most desirable time to purchase good-grade as distinct from high-grade bonds is when security prices generally are low.

The earmarks of high-grade preferred stocks are: a high rate of coverage for preferred dividends and all prior charges, and relatively little or nothing in the form of debt with a prior claim on earnings and assets. Like good-grade bonds, the most advantageous time to buy preferred stocks is when security prices generally are depressed and yields are relatively high. This is progressively true the lower the investor goes in the grade of issues selected to buy.

4. For capital appreciation -- common stocks.

Capital appreciation should not constitute the investor's sole objective in investing in common stocks. Other objectives should be income and the diversification of assets. There are three standard approaches which, singly or in combination, may be employed properly to secure capital appreciation in common stocks.

The first of these approaches, and the one best suited to the average investor, is to seek capital appreciation by buying common stocks when their prices are sufficiently low to make them appear attractive investments for income over the years, and to sell them when prices are sufficiently high to make them appear unattractive investments for income over the years at prevailing prices.

The second approach is directed toward seeking capital appreciation in common stocks as the result of the growth in earning power of the corporations in question.

The third approach is to endeavor to buy common stocks when they are low and sell them when they are high, more with regard to past and prospective price movements than to the income to be received or the long-term outlook for

earnings.[12]

Investment Rules

Barnes has published the following investment rules which appear to be quite realistic:

In Selecting and Holding Investments
The Investor Should --

1. Investigate before investing.

2. Decide what combination of conservative, enterprising and speculative investing is appropriate.

3. Not expect too much too soon.

4. Not strive too hard for yield; because tax-sheltered capital growth almost always will give more after taxes than fully taxed income.

5. Continually be concerned with the investment implications of new developments in science, technology, domestic and international politics.

6. Review his portfolio periodically.

7. Be prepared for the unexpected.

8. Specialize, keeping investment candidates selective and small.

9. Act once a decision has been made.

10. Strive mightily to avoid irresistable temptation to break his own investment rules.

In Buying and Selling Securities
The Investor Should --

1. Decide how much return is hoped for before making a commitment.

2. Be convinced that the prospect for the company is favorable for at least the next year, before buying a stock.

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[12] Effinger, op. cit., pp. 11-19.

3. Be reasonably sure that a sum available for investment is being put to its best use under current conditions.

4. Check whether his investment targets might not be more effectively achieved by the related convertible bond or preferred stock rather than the common stock.

5. Think twice before buying a stock immediately after a substantial rise -- or selling a stock immediately after a substantial drop -- in its price.

6. Close out wrong decisions and losses quickly.

7. Not cash in profits prematurely.

8. Not let factors override investment considerations.

9. Be sure he is aware of approaching dividend and earnings report dates.[13]

Determining the Need for Professional Assistance

After deciding what kind of an investor he is, and after determining what his investment objectives are and how he ranks them in importance, the individual must make another basic decision. He must decide whether he should do his own investing, relying on and choosing from the wealth of advice available; or whether he should assign the task to others. In some cases, the investor may find that it would be beneficial to him to take both courses of action. It is speculated that the latter prerogative would best suit the Marine officer.

If the investor has very little time to devote to investment analysis and knows virtually nothing of the criteria then his course of action must

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[13]Barnes, *op. cit.*, pp. 14-15.

undoubtedly be one of assigning the task to others.

If the individual can systematically and regularly devote several hours per week to his investments and is well equipped with the techniques of investment then he may be as well or better off investing on his own.

Finally, if the investor has some time to devote to his investments but not as much as he feels is necessary and is well-versed in the basic investment doctrine -- then a combination of self-investment and investment by others will probably be the best answer.

Sources of Advice

The investment of money in securities is unique among business operations in that it is almost always based in some degree on advice received from others. The great bulk of investors are amateurs. Naturally, they feel that in choosing their securities they can profit by professional guidance.

> The investment adviser will use his superior training and experience to protect his clients against mistakes and to make sure that they obtain the results to which their money is entitled. It is when the investor demands more than an average return on his money or when his adviser undertakes to do better for him, that the question arises whether more is being asked or promised than is likely to be delivered.[14]

Advice on investments may be obtained from a variety of sources only a few of which will be described here. These include: (1) a relative or friend, presumably knowledgeable in securities; (2) a local (commercial) banker; (3) an investment counselor; (4) a financial service or periodical; and (5) a brokerage firm or investment banking house.

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[14]Benjamin Graham, The Intelligent Investor (New York: Harper & Bros. Publishers, 1954), p. 49.

If the investor is to rely chiefly on the advice of others in handling his funds, then either he must limit himself and his advisors strictly to standard, conservative, and even unimaginative forms of investment, or he must have an unusually intimate and favorable knowledge of the person who is going to direct his funds into other channels. Where the ordinary business or professional relationship exists between the investor and his advisers he can be receptive to less conventional suggestions only to the extent that he himself has grown in knowledge and experience and has, therefore, become competent to pass independent judgment on the recommendations of others.

The Investment Counselor

> The private investment counsel firms, on a fee basis, provide total guidance and management of investment accounts. They offer professional services in investment management. They do not buy or sell securities but will handle such orders for the investor's account, through the brokerage firm he may designate. . . . They make their primary appeal to the larger ($100,000 and over) investment accounts.[15]

The well-established investment counsel firms (Scudder, Stevens & Clark, etc.) are the most modest in their promises and invest clients' funds in standard interest- and dividend-paying securities, and they rely mainly on normal investment experience for their overall results.

> The primary responsibility of the investment adviser is to provide continuous supervision of the security portfolios and other investments of his clients (individual as well as institutional).[16]

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[15]Ira U. Cobleigh, Guide to Success in the Stock Market (New York: Avon Book Division, The Hearst Corp., 1961), p. 101.

[16]Edward C. Delafield, "The Gentle Art of Conserving Capital," Wall Street 20th Century, ed. John Neumark (Conn: Yale News, 1960,)p.134.

Financial Services

The so-called financial services are organizations that send out uniform bulletins to their subscribers. The subjects covered may include the state and prospects of business, the behavior and prospects of the securities markets, and information and advice regarding individual issues.

For example:

> In my opinion, United Fruit (around 20) could be a very interesting long-term speculation. For one thing, there's an entirely new management philosophy and an attempt apparently is being made to transform United Fruit from a banana farmer to a merchant and food processor. . . . Last year's earnings were nominal, but 1961 should make much more pleasant reading.[17]

> Apparently stimulated by the success of the "compact" car, manufacturers in other industries are emphasizing compactness in their products. R.C.A.-Whirlpool claims that its new 1961 model occupies 100 square inches less floor space than its 1960 counterpart, yet handles the same load of laundry. Glass container makers now refer to the new "squat," shortnecked, one-use beer bottle as their "compact" model.[18]

> Another sharp rise in sales and earnings is shaping up this year for the Magnavox Company, Incorporated, an important producer of television receivers and military electronic equipment. Brightening the outlook are large defense orders, new products and plant efficiency.[19]

> Westinghouse is the second largest of the electrical equipment makers, and the company may be expected to participate fully in the growth that lies ahead in the electric and electronic fields and in the commercial development of atomic energy. The COMMON stock is regarded as a sound long-range holding. The PREFERRED is a high-grade income issue.[20]

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[17] Sidney B. Lurie, "The Market Outlook," Forbes, February 15, 1961.

[18] Dun's Review and Modern Industry, January, 1961.

[19] Barron's National Business and Financial Weekly (Boston), January 30, 1961.

[20] Standard Listed Stock Reports, (Standard & Poor's Corp. Lancaster, Pa.) October 28, 1960.

> Not only will Sheraton continue to benefit from trends favoring its hotel operations, but its diversifications into areas of demonstrated growth through investments in Diner's Club and Thompson Industries gives additional support to its fundamental position. The stock is an effective commitment for portfolios stressing long-range capital increase.[21]

> National Dairy Products is by far the largest company in its field. Sales have gained consistently for a number of years, except for a minor lapse in 1954, and earnings have risen each year since 1951. Sales for 1960 are estimated at a new peak, about 4-1/2% higher than the $1.6 billion of 1959, but increased costs are believed to have held earnings to around $3.55 a share, still a new high. . . . The shares are an investment grade medium for secure, but moderate, yield and longer-term appreciation.[22]

The cost of the service averages much less than the fee that investment counselors charge their individual clients.

The financial services direct themselves, on the whole, to a quite different segment of the public than do the investment counsel firms. The latter's clients generally wish to be relieved of bother and the need for making decisions. The financial services offer information and guidance to those who are directing their own financial affairs or are themselves advising others.

Some of the best known -- such as Standard & Poor's, Moody's Investment Service, or Fitch -- are identified with statistical organizations that compile voluminous data that form the basis for all serious security analysis. These services have a varied clientele, ranging from the most conservative-minded investor to the rankest speculator.

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[21] Forbes Guide to Common Stock Profits (New York: Investors Advisory Institute, 1959), p. 38.

[22] Standard & Poor's Corp., The Outlook, March 6, 1961, p. 907.

Standard & Poor's has its weekly Outlook, a twelve-page weekly market letter ($65 a year), a daily Facts and Forecast Service,($150), an Investment Advisory Survey ($65), and a Portfolio Review Service ($100). Moody's publishes a Stock Survey ($144 a year), which reviews market conditions and analyzes various investment opportunities; and an Investors Advisory Service which offers subscribers a review of their present holdings plus constant supervision of their portfolio at the cost of $184 for a portfolio of 15 stocks or less.

An old-established service of the type of Moody's and the others must obviously provide something worthwhile to a broad class of investors. What is it? Basically they address themselves to the matters in which the average active investor is interested, and their views on these either command some measure of authority or at least appear more reliable than those of the unaided client.

For years such financial services as The Commercial and Financial Chronicle, Forbes Magazine, Barron's, The Financial World, and The Magazine of Wall Street have been making stock market forecasts. Like everyone else in the field, they are sometimes right and sometimes wrong.

Their interpretations and forecasts of business conditions, of course, are much more authoritative and informing. These are an important part of the great body of economic intelligence which is spread continuously among buyers and sellers of securities and tend to create fairly rational prices for stocks and bonds under most circumstances. Undoubtedly the material published by the financial services adds to the store of information available and fortifies the investment judgment of their clients.

The intelligent investor will not do his buying and selling solely on the basis of recommendations received from a financial service. Once this point is established, the role of the financial service then becomes the useful one of supplying information and offering suggestions.[23]

The Stock Broker

Probably the largest volume of information and advice to the security-owning public comes from stock brokers. These are members of the New York Stock Exchange, and of other exchanges, who execute buying and selling orders for a standard commission. The broker does not (usually) sell the investor securities that he owns but rather acts as the investor's agent. He will execute an order to buy or sell securities in any market, listed or over-the-counter.

The commission rates on all major exchanges are fixed; and they vary according to the price range of the stock purchased and the regulations of each exchange.

Brokerage companies usually have extensive research and investment analysis facilities. A great deal of analytical literature, some of it elaborate and expensive is distributed gratis to the firms' clients. The broker can be a valuable ally in achieving good results in securities.

Such established firms as Merrill Lynch, Pierce, Fenner, and Smith, Bache, Dupont, and Kidder Peabody are registered by the New York Stock Exchange and can be considered quite reliable.[24]

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[23]Graham, op. cit., pp. 51-52.

[24]Cobleigh, op. cit., pp. 99-100.

TABLE 18

SCHEDULES OF COMMISSIONS[a]

(Buying or Selling One Hundred Shares)[b]	
Amount	Commission
Under $100	Commission here is on a mutual agreement basis between the broker and the customer and normally works out at about 6 per cent.
Between $100-$399	2 per cent plus $3
Between $400-$2,199	1 per cent plus $7
Between $2,200-$4,999	1/2 of 1 per cent plus $19
$5,000 and above	1/10 of 1 per cent plus $39
(Buying or Selling Less Than 100 Shares "Odd Lots")	
Stocks less than $40 per share	12-1/2¢ higher than current market value per share
Stocks more than $40 per share	25¢ per share

[a]Don G. Campbell, Let's Take Stock (Indianapolis: Bobbs-Merrill Co., Inc., 1959), p. 30-31.

[b]The dollar amount shown indicates the size of the total transaction.

> The average broker is inclined to be a somewhat dyspeptic gentleman with either a nervous squint from attempting to read one-inch-high stock quotations from the far side of a room or with a perennially bruised nose caused by slapping a pair of small field glasses to his eyes hour after hour. He normally lives in the suburbs, drives a late-model car and has a daughter who plays the piano.
>
> A good part of the broker's chronic stomach trouble is a result of the strain that anyone suffers who is presumed to be infallible in his decisions and who is expected to possess an encyclopedic knowledge of every manufacturing firm in the United States, ranging in size from General Motors down to obscure little two-men partnerships that specialize in the fabrication of plastic shoestring tips.[25]

Final Analysis

This writer believes that after an adequate insurance and savings bulwark has been provided, every portfolio should contain some speculative holdings. It is in this context that the author would like to consider the Marine officer (at least one who has attained the rank of major) as an enterprising investor.

The long range tendency in this country has consistently moved towards a progressively decreasing purchasing power of the dollar. The "threat of inflation" is not merely a transitory phenomenon; it is a permanent and apparently inevitable trend in our nation's basic economy. Only the enterprising investor can maintain equilibrium in such an economy.

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[25] Campbell, op. cit., p. 27.

TABLE 19

SAMPLE PORTFOLIO A[a]

STOCKS AND BONDS FOR HIGH CURRENT INCOME
(Excerpts)

Anthony Pools	Illinois Brick
Detroit & Can. Tunnel	Missouri-Kansas-Texas 5s, 1967
Foremost Dairies	Missouri Pacific 5's 2045
General Candy	Pan American Sulphur

[a]Barnes, op. cit., p. 141.

TABLE 20

SAMPLE PORTFOLIO B[a]

COMMON STOCKS FOR SAFETY (Excerpts)

Amer. Home Prods.	Proctor & Gamble
Amer. Natural Gas	Reynolds Tobacco
Amer. Tobacco	Union Carbide
Intl. Bus. Machines	U. S. Gypsum

[a]Ibid.

TABLE 21

SAMPLE PORTFOLIO C[a]

CONSERVATIVE ISSUES FOR LONG-TERM GROWTH
AND LARGE FUTURE INCOME
(Excerpts)

Avon Products	Hertz Corp.
Dun & Bradstreet	Otis Elevator
Florida Power Corp.	Prentice-Hall
Gillette	Revlon

[a]Ibid.

CHAPTER V

SECURITY SELECTION

Even with proper allocation of funds and a sound general policy, the success or failure of an investment program ultimately will depend on the selection of individual securities. A thorough discussion of security analysis will not be attempted in this report. Instead, a suitable method of classifying the desirable attributes of industries and companies will be described and some of the financial criteria used in selecting common stocks will be outlined.

The problem of selection is complicated by the vast extent of business enterprise, by the great number of companies that have securities outstanding, and by the wide variety of activities in which the companies are engaged. Business concerns found in the United States may be classified according to the product or service that they produce.

The following five major categories of enterprise may be distinguished: transportation, public utilities, natural resource industries, financial companies, and miscellaneous special industries. The transportation section includes the railroad, air-transport, bus, truck, and shipping industries. The public utilities include communications, electric-light and power, and natural-gas pipe-line industries. The enterprises included under the classification of

natural-resource industries are those engaged in the production of aluminum, copper, gold, lead, silver, zinc, and other non-ferrous metals, iron and steel, petroleum, and coal. Insurance companies, banks, and loan companies constitute most of the financial companies.

The special-industries classification may be subdivided into groups of industries manufacturing producers' goods, industries supplying consumers' goods, and industries providing services. Producer-goods industries include companies manufacturing chemicals, aircraft, and office, plant, farm, electrical, railroad, and construction equipment. Consumer-goods industries are composed of those companies that produce automobiles, beverages, food products, household equipment, paper, drugs, textiles, and tobacco, as well as those companies engaged in retail trade and amusement items. Among the producers of services are the moving-picture companies, the radio-broadcasting companies, etc.

This classification of the major fields of enterprise indicates the wide diversification of industries available to the investor. However, such a classification of itself does not assist the investor in selecting suitable securities for his fund; and a more critical basis of classification must be sought.[1]

Basic Criteria

Before discussing the somewhat complex criteria involved in security analysis, it would be appropriate to briefly mention the general characteristics

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[1]E. C. Harwood, How to Invest Wisely (Pittsfield, Mass.: The Ben Franklin Press, Inc., 1955), pp. 49-50.

common to all companies that have a bearing on the long-term investment prospects of their securities. These characteristics provide a basis for the differentiation between securities that are unsuitable and those that are desirable for a portfolio.

1. Growth. A favorable long-term growth is one of the more important attributes of a company in which an investment may be made. In his selection of individual corporations the investor must analyze first the growth prospects of the industry in relation to the industrial and population growth of the country as a whole, then endeavor to select companies that are expanding at a rate faster than the rest of the industry. Ordinarily, investments in the stocks of companies in industries with favorable growth trends will provide the greatest degree of safety and potentialities for appreciation.

A growth company is one --

> a. Which is in one or more industries that have grown faster than the average of all United States business in the past and will probably continue to do so in the future.
> b. Whose earnings per share have in recent years increased at a notably faster pace than both the average industrial company and the average company in its industry (ies), and -- because of projected market growth, new product development, research leadership, or other factors of strength -- promise to continue to do so in the future.
> c. Whose current price in the stock market leaves room for better-than-average appreciation in the period of years in which the individual plans to hold the stocks.[2]

2. Management. Superior management is a definite advantage to any corporation. When little differentiation can be made between the products or services, differences in management policy often are the decisive factors

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[2]Leo Barnes, Your Investments (New York: American Research Council, Inc., 1961), p. 37.

accounting for differences in profits among companies. An aggressive sales policy, intensive research in the development of new products, adaptation of old products to new uses, and continuous effort to improve production techniques are characteristics of superior management.

Specifically, good management is often indicated by improvement in the profit margin of a company. As sales increase, the operating profits (that is, the profits derived directly from the primary operations of the business before deductions for taxes, interest, and other non-operating charges) may increase at a faster rate. Moreover, the profit margin may be maintained or improved in spite of a sales decrease if the percentage reduction in the operating profit is less than the percentage decrease in sales. The relative profit margins of companies in a particular industry will help to indicate the relative competitive strength of a company.

3. Improved Technology. The technological advance of industry is a major feature in considering its investment potential. Progress of this type consists of finding new relationships between resources in the natural state or making use of relationships already discovered in the production of goods and services. Leadership in the technological advance of industry is an important and desirable characteristic of a good company.

Technological progress in a corporation can be applied by (a) the introduction of new capital equipment or production techniques that replace or reduce manual operations; (b) the modification of the character of capital goods already in use; (c) the more effective use of raw materials; and (d) an increasing diversity of products as well as improvement in items already available.

4. Monopoly Privilege. Companies or industries that possess an artificial monopoly of a product or service often offer favorable investment. The possession of a monopoly privilege may offset to a limited degree some less desirable characteristics, such as a relatively moderate rate of growth or government regulation of operations and earnings.

5. Cyclical Characteristics. The cyclical nature of demand for products of various industries must also be considered by the investor, especially in the selection of common stocks. Various indexes clearly demonstrate that production of consumer goods fluctuates less than that of durable producer goods. Therefore, the earnings of the capital-goods industries ordinarily are not so stable as those of companies producing goods for personal consumption. On the other hand, the long-term record of the less-stable industries in numerous instances has been more favorable than that of industries producing consumer goods. Moreover, in most cases, the earnings of capital-goods industries tend to increase faster and further during an inflationary boom than those of companies producing consumers goods.[3]

Security Analysis

"Security analysis might be defined, at least in a strict sense, as the technique of selecting 'good buys'."[4] Numerous factors must be considered in the analysis of securities of individual companies. Various methods of

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[3]Harwood, op. cit., pp. 50-63.

[4]George H. Evans, Jr. and George E. Barnett, Principles of Investment (Boston: Houghton Mifflin Co., 1940), p. 169.

TABLE 22

PANORAMA OF UNITED STATES INDUSTRIES[a]
(Excerpts)

Growth Industries of Tomorrow		Mature Industries	Declining Industries
Fast Future Growth Comparatively Stable	Moderate Future Growth Comparatively Stable	Average Growth Comparatively Stable	No Growth or Shrinkage Moderately Cyclical
Atomic Energy Electric Fuel Cells Infrared Natural Gas Solar Energy Textbooks	Dairy Products Electric Utilities Food Chains Insurance Petroleum Soft Drinks	Banks Baking Cosmetics Glass Containers Tobacco Variety Chains	Department Stores Leather Movie Theaters
Moderately Stable	Moderately Cyclical	Moderately Cyclical	Very Cyclical
Air conditioning Boats and Supplies Bowling Equipment Drugs, Ethical Helicopters Photoprinting Television, Color	Aluminum Fertilizers Paper and Pulp Toys	Apparel Chains Dental Supplies Meat Packing Shoes Tires	Railroads Tin Zinc
	Very Cyclical	Very Cyclical	
	Cement Electrical Appliances Machine Tools Trucks	Autos Carpets & Rugs Coal Jewelry Sugar	

[a]Barnes, *op. cit.*, p. 39.

analysis emphasize different factors, and there probably is no one generally accepted procedure. However, most methods include consideration of the general characteristics of the industry and the peculiar characteristics of the company, as well as financial factors. This section is concerned with the latter category as applicable to the common stock selection of a corporation (sometimes referred to as the "value or financial approach").

The background analysis should include consideration of the company's history and present status. The nature of the product or service produced, the territory or type of market served, management policies, and any other pertinent information concerning the actual nature of operations of the company should be considered.

To complement the foregoing information, an accounting analysis or financial approach to the company under study can prove to be quite beneficial. For most investors this type of analysis is most difficult; but if the required work is performed, the individual can be rewarded with a sound investment.

> Accounting analysis, which is the study of business records such as the income statement and the balance sheet, is used mainly by those who are attempting to locate securities that may be viewed as selling "out of line." Perhaps it would be more appropriate to say that the analyst is endeavoring to learn the nature of the internal uncertainty which is attached to a given security.[5]

This approach consists primarily of constructing and comparing a number of ratios for more or less like companies for a point in time against industry standards; and of studying the trends in these ratios (and sometimes the raw data rather than a ratio) over a period of time.

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[5]Ibid., pp. 172-173.

In view of the fact that these ratios and raw data are compiled from information contained in financial statements, the following discussion must be predicated on the assumption that the reader is at least vaguely familiar with corporate financial records.[6]

One of the first steps in this form of analysis is to adjust the company's reports where there is good reason to believe that alteration is necessary. Non-recurrent income, for example, may be eliminated from the income statement to prevent distortions of general movements.

After such adjustments have been made the analyst proceeds to the calculation of a number of ratios which are examined with a view to uncovering favorable or unfavorable conditions, particularly the latter. Like ratios of a group of similar companies may be calculated and averaged to give a "standard," or the standard may be named on the basis of past experience by those having intimate knowledge of the history of the industry involved.[7] Each particular ratio can then be projected against the standard. Or the ratio of one company may be compared with the corresponding ratio of another similar company without the determination of a standard.

For example:

> The net working capital represents a margin of safety for the current creditors. The larger the amount of net working capital in relation to current liabilities, the more favorable the position will be with reference to meet current debts and to absorb

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[6]Capable discussion of financial statements and their analysis is contained in Ralph D. Kennedy and Stewart J. McMullen, Financial Statements (Homewood, Ill., Richard D. Irwin, Inc., 1957).

[7]Dun & Bradstreet, Inc. publishes pertinent industry ratios annually which can be obtained usually for the asking.

operating losses. General Electric's net working capital in 1959 of $828.0 certainly compares favorably with Westinghouse's $768.0, RCA's $316.1, and Sperry-Rand's $293.9.[8]

Among the ratios most frequently calculated are the following:

1. Those designed to reveal the current debt paying ability and current financial status. Of this type are the current ratio (current assets divided by current liabilities), turnover of trade receivables (net sales divided by trade receivables), and turnover of inventory (cost of goods sold divided by ending inventory).

2. Those designed to indicate the long-term financial position as viewed by the bondholder. Of this type are the ratio of current assets to total liabilities (current assets divided by total liabilities) and the times fixed interest charges are earned (net income before fixed interest charges divided by fixed interest charges).

3. Those designed to determine the long-term financial position as viewed by the stockholder. In this category are the proprietary ratio (owners' equity divided by total assets), earnings on common stock (net income after deducting preferred dividend requirements divided by number of shares of common outstanding), and the book value of common stock (common stock equity divided by the number of common shares outstanding).

4. Those used to analyze operating performance. Included here are the ratio of gross profit to net sales (gross profit divided by net sales), and the operating ratio (total of cost of goods sold and operating expenses divided by net sales).

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[8]Daniel J. Ford, "A Financial Analysis of General Electric Company" (unpublished term paper, School of Government, Business & International Affairs, The George Washington University, 1961), p. 23.

Probably the most significant individual ratios and data are:

1. The proprietary ratio

2. Current ratio

3. Operating ratio

4. Earning rates (price-earnings ratio, price earnings multiple and earnings yield)

5. Net working capital.[9]

The proprietary ratio shows the percentage of the total assets that has been financed by the stockholders. This ratio is a measure of the relative financial strength and reflects the presence or absence of long-term debt pressure. A relatively high proprietary ratio reflects less likelihood of financial difficulty resulting from heavy fixed interest charges and inability to meet maturing debt obligations. A relatively low proprietary ratio reflects a more speculative situation because of the possibility of high profits or losses.[10]

The above explanation has even greater implications for those investors seeking long-term growth and inflation protection in common stocks. The low proprietary ratio may be indicative of the presence of strong "leverage."

> Debt-free stocks with "clean capitalizations" -- while they may be of interest to income investors -- are not particularly attractive as such to investors seeking long-term growth and inflation protection. For substantial debt -- rather than being a sign of inadequate earnings or internal resources -- is often a clue to a company's determination to expand its operations at the maximum possible rate. . . .

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[9] Rufus Wixon (ed.), Accountants' Handbook (New York: The Ronald Press Co., 1957), pp. 3.8-3.9.

[10] Kennedy and McMullen, op. cit., pp. 297-298.

> Leverage means using either borrowed funds or the right to acquire securities via put and call options or warrants as a "lever" for increasing possible profit -- or loss! It is a technique for making a little do a lot.
>
> Where preferred stocks, bonds, or other borrowed funds are involved, leverage is effective because these forms of "prior capitalization" have a first claim on earnings before the common stock. But this prior claim is fixed in amount. It does not go up when earnings increase, or go down when earnings decline. Therefore, any increase or decrease in earnings above the fixed charges on prior capitalization has a multiplied effect on the common stock.[11]

The current ratio gives evidence of the relative liquidity of the business, i.e., the ability to meet current debts as they mature. The adequacy of this ratio depends upon a number of factors, such as the terms of buying and selling; the turnover of receivables and inventories; characteristics of the general financial program; the season of the year; the business cycle period; and whether or not the business is expanding or contracting.

A current ratio of 200 per cent is sometimes considered to be an ideal ratio. However, since the amount of working capital and the size of the ratio depend upon many factors, a standard current ratio cannot be designated as ideal for all businesses. Usually, the tobacco industry, for example, will exhibit high ratios while the railroads will exhibit much lower percentiles. Prior to basing any decision upon this figure, the analyst must first understand the character of the business in which the company is engaged.

The operating ratio commonly referred to as the profit margin shows the percentage of the net sales that has been absorbed by the cost of goods sold and operating expenses. The higher the operating ratio, the less favorable,

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[11]Barnes, *op. cit.*, p. 62.

since the smaller amount of profit may not be sufficient to meet interest, dividends, and other company needs.

In interpreting the operating ratio full recognition must be given to the possibility of variations in expenses from year to year or from company to company due to changes or differences in policies involving expenses which are subject to managerial discretion. This ratio is a fairly good index of operating efficiency. Companies with the lowest operating ratio, assuming a fair condition relative to financial and extraordinary items, have the least to fear during periods of business inactivity, since their profit can shrink considerably before a dangerous situation develops.[12]

TABLE 23

COMPANIES WITH RISING PROFIT MARGINS[a]
(Excerpts)

American Distilling	Amphenol-Borg
General Foods	Emerson Electric
Jewel Tea	Liggett & Myers
National Biscuit	Parke-Davis
Polaroid	Reynolds Tobacco

[a]Barnes, op. cit., p. 45.

The earnings rate -- the price-earnings ratio, price-earnings multiple and earnings yield -- are measures which relate the price per share to annual net earnings per share and are extremely significant to the individual investor.

[12]Kennedy and McMullen, op. cit., pp. 287-288.

The buyer of common stocks is often more concerned with the earnings per share of his stock than he is with the dividend. It is usually earnings per share or, rather, prospective earnings per share, that influence stock market prices.[13]

Which price and which earnings the analyst or investor selects to relate can be varied for different purposes. Most customary are the relations between current price and the latest reported annual earnings.

Thus, a current price of 48 and annual earnings of $3 per share result in a price-earnings ratio of 16 to 1, a price-earnings multiple of 16, and an earnings yield of 6.25%.

In addition, either current, past, or average prices of a stock can be related to either past or expected future earnings.

TABLE 24

LOW PRICE-EARNINGS MULTIPLES FOR MAJOR INDUSTRIES[a]
(Excerpts)

Industry	Low P-E Multiple
Aluminum	16.0
Autos	8.0
Containers	12.5
Drugs & Pharmaceuticals	14.0
Electric Utility	14.0
Food Products	11.0
Petroleum	10.0
Railroads	7.0
Telephone	13.5
Tobacco	11.0

[a]Barnes, _op. cit_., p. 56.

[13]_How to Read a Financial Report_ (New York: Merrill Lynch, Pierce, Fenner & Smith, Inc., 1960), p. 27.

TABLE 25

SELECTED STOCKS SELLING AT LOW PRICE-EARNINGS RATIO[a]
(Excerpts)

Borg-Warner	Manhattan Shirt
Dan River Mills	Minute Maid
Eagle-Picker	Northrop Corp.
Gulf Oil	Skelly Oil
Illinois Central	U. S. Rubber

[a]Barnes, op. cit., p. 56.

The price-earnings ratio usually gives a more trustworthy indication of the relative desirability of a given stock than is afforded by the dividend yield. As a stock advances in price, assuming that the net earnings and dividend rate remain unchanged, the price-earnings ratio factor increases and the yield decreases in the same proportions. A decline in the market price, under the same conditions, will cause a proportionate reversal of both trends.

If the investor has a choice of two stocks that are seemingly of equal merit, the one with the higher yield and the lower price earnings ratio will apparently constitute the better buy at current prices. If both have the same dividend yield, the lower price earnings ratio should indicate the stock more favorably priced from the buyer's standpoint.[14]

Net working capital is the difference between current assets and current liabilities, the amount of the current assets that has been supplied by the long-term creditors and the stockholders. Assets included are of varying degrees of liquidity -- ranging from cash and government bonds, through accounts

[14]Robert U. Cooper, Investments for Professional People (New York: The MacMillan Co., 1959), p. 204.

receivable, to the value of a company's inventories. This definition is qualitative in character, since it shows the possible availability of current assets in excess of the current liabilities; it represents an index of financial soundness or margin of protection for current creditors and future current operations.

The immediate availability of working capital depends upon the type and liquid nature of the current assets. When working capital is defined in this way, it cannot be increased by current loans from banks or extension of credit by trade creditors.[15]

The net working capital per share of common stock (after deduction of senior obligations) is often calculated to indicate a liquid sum that belongs to the stockholder regardless of how undesirable the business may be. A strong working capital position is highly desirable, but it is no substitute for earning power and dividends.[16]

The Financial Report

The term "financial report" is commonly applied to a company's balance sheet and statement of income and retained earnings. Those corporations listed on the New York Stock Exchange are required to publish periodically the financial data reflecting the firm's condition and operating results. All corporate enterprises annually publish a report reflecting the year's progress in financial language.

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[15] Kennedy and McMullen, op. cit., p. 208.

[16] George W. Dowrie and Douglas R. Fuller, Investments (New York: John Wiley & Sons, Inc., 1950), pp. 511-512.

It is not within the scope of this writing to discuss the elements which make up these reports or even the reports themselves. However, it seems necessary to at least point out certain significant items which the analytically inclined investor might examine in any corporate financial report.

In following the value-financial approach, the investor should endeavor to answer the following questions before he invests in the stock of a company:

1. <u>What is the trend in a company's operating efficiency</u>? This is the ultimate competitive challenge to a company's management. How does the latest operating ratio compare with the average of the previous five years? With that of the previous year? How does the company compare with others in its industry?

2. <u>What is the growth trend in earnings per share</u>? How do current earnings before taxes compare with those of a year ago? With the average of the previous five years? Has the introduction or expansion of a profit-sharing plan for officers and employees improved efficiency enough to offset the added cost per share?

3. <u>How do the reported earnings of the company compare with its cash earnings</u>? Reported earnings will often be misleading unless given further analysis. Balance sheets and income statements should be checked for evidence of both concealed and exaggerated earnings. The investor should examine the accounting of extraordinary, one-time profits or losses; high write-offs for contingencies; high reserves; foreign earnings or earnings of subsidiaries; and the depreciation expense as compared to that of the industry.

4. <u>What is the trend in the company's rate of dividend payments per share</u>? How does said rate compare with the average of the previous five years? With that of the previous year?

5. <u>If a company has bonds ahead of the common stock, how many times is the annual total of bond interest and amortization requirements covered by yearly net earnings</u>? Bond coverage should be very, very ample.

6. <u>If a company has preferred stock ahead of the common, how many times are the annual dividend requirements on the preferred covered by net earnings</u>? Has the company ever failed to earn its preferred dividends? Are there any dividend arrears currently outstanding on the preferred that have to be paid?

7. <u>How much does the company regularly and systematically spend for new plant and equipment</u>? How much per share has been spent in the past five years? Substantial outlays are necessary to maintain competitive position and to provide the basis of future earning power.

8. <u>How much does the company regularly spend on research and development</u>? How much per share has been spent in the last five years? For the nation as a whole, dollars spent each year on scientific and engineering research have gone up more than 60 per cent since 1950.

9. <u>Has the company any especially valuable properties or investments outside its regular line of business</u>? In these days of business diversification, investors should look for hidden values from company holdings in oil, uranium, television stations, real estate, etc.[17]

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[17]Barnes, <u>op. cit</u>., pp. 57-58.

Virtually all of the information needed to examine the foregoing sets of questions is to be found in the corporation's annual report and in the standard statistical summaries of individual companies published by Moody's or Standard & Poor's.

Industry Analysis

Before the investor begins to analyze the securities of a particular company, he usually has first to select the right industry which exhibits the characteristics commensurate with the individual's investment objectives. Selecting a good company in a poorly situated industry can sometimes make the investor money, but he will do far better by choosing a sound company in a well-situated industry.

Careful industry selection is doubly important when the stock market trend is wavering and uncertain. In such markets, stocks of some industries will be on the incline, and stocks of other industries on the decline, at the same time. However, even in strong upward-moving markets, it is customary for some industry groups to decline.

The present and probable future economic position of an industry are basic in investment selection. Different industries have different patterns of (1) long-term growth or decline; (2) cyclical fluctuations in sales, prices, and earnings; and (3) seasonal changes in activity. All these affect stock prices.

Most investors will want to choose industries that are currently healthy and are likely to remain so. On the other hand, speculatively inclined investors can often make more money on the wider stock price swings typical of cyclical or unstable industries. In particular, large gains can sometimes be

achieved by investing in depressed industries just before they are due for a cyclical turn for the better.

The market technicians hold that market action or performance is the real test of the investment desirability of an industry. For the technician, the proper industry analysis consists of asking just two questions: (1) How has the industry been performing in the stock market relative to all other industries? (2) What are the technical indications of the industry's relative stock market performance in the future?

The idea, of course, is to project past and recent industry trends into the future. The strict technician will do so by following the course of the market itself -- assuming simply that a rising relative industry position in the past will continue until the market itself indicates a reversal.

The investor can get a relatively high degree of income and appreciation with relatively little risk by (1) concentrating his holdings in the top five or seven industry groups; and (2) shifting once or twice a year to keep invested only in the top groups.

Many more cautious investors will completely reject the industry-ranking techniques described above. Especially for the conservative long-pull investor, switching stocks once or twice a year is too uncertain, too disturbing, and, probably, too costly. Therefore, for long-term investors, the only safety lies in diversification, not concentration of holdings.

A customary rule for such diversification is that the most one should invest in any single industry is 10 per cent of his fund; the most in any one company 5 per cent of his fund.

Actually, the economic, technical, and safety approaches to industry selection can often be combined. When the individual has chosen a sound industry on economic grounds, and it is also in a strong technical position, he has an excellent combination.

TABLE 26

INDUSTRY RANKINGS OF COMMON STOCKS HELD BY TWENTY MUTUAL FUNDS[a]

Industry	Rank	1959-% of Common Stocks	Rank	1958-% of Common Stocks
Oil	1	11.8	1	15.4
Financial	2	10.9	2	10.7
Public Utility	3	10.3	3	10.2
Steel	4	6.9	4	7.1
Chemicals	5	6.2	5	5.1
Metals & mining	6	4.3	8	4.2
Automobiles	7	3.9	14	2.9
Railroad	8	3.9	6	4.6
Drugs	9	3.7	9	3.7
Electrical Equipment	10	3.5	15	2.0

[a]Barnes, op. cit., p. 20.

In the final analysis, it is well recognized that the majority of Marine officers are not experienced security analysts and do not have time to acquaint themselves with all of the reference material used by the professional. However, it is quite important, in the interest of profitable investment, that he become familiar with the few sources that have been mentioned here, so he can consult them with ease and confidence. Moreover, it is hoped that the foregoing discussion has left with the reader the impression that security and industrial analysis (at least to the extent set forth) is not an arbitrary approach, but a

very necessary factor in security selection. The aspiring investor, therefore, should not shy away from these financial aids, but, rather, he should use them to his own advantage.

CHAPTER VI

THE FOLKLORE OF THE MARKET

The jargon of Wall Street is extensive. To be all-inclusive a discussion of the many terms in the specialized vocabulary of the investment field, with its many idiomatic phrases, would require much more space than can be allotted here. For this reason, there is included in appendix form a glossary of the more common words and phrases that make up the special language of the market. This chapter is reserved for a discussion of the more important elements in the argot of the financial world -- to include description of such heterogeneous items as the New York Stock Exchange, the over-the-counter market, put and call options, margin buying, and interpretation of financial news.

The New York Stock Exchange

The New York Stock Exchange, commonly referred to as the "big board," is a market place for securities. (More than 2,680 issues of stocks and bonds are currently listed).

It is a vast trading floor in a building at the corner of Broad and Wall Streets, New York City. It is the nation's largest organized securities market, where hundreds of exchange member brokers daily buy and sell, for thousands of people, the stocks and bonds of America's leading corporations.

> The New York Stock Exchange, considered in the full scope of its organization and its facilities, is an adjunct of the entire securities industry.[1]

The exchange is a market place where prices reflect the basic law of supply and demand. It is a market place where shares in American Industry can be bought and sold almost as readily as the individual can deposit money in the bank. This fact is true whether he lives in a city of five million or in a town of five thousand, whether he lives in Portland, Maine, or Portland, Oregon. Membership in the exchange at present totals 1,366 individuals. A member may be a partner or holder of voting stock in one of the brokerage firms which, by virtue of his exchange membership, is known as a member firm or member corporation. There are 661 such member organizations. From the founding of the exchange in 1792, until May, 1953, member organizations were limited to partnerships. At that time the exchange's constitution was amended to permit corporations to become member organizations -- provided such corporations are engaged primarily in the securities business as dealers or brokers.

The constitution makes provision for 1,375 members, or such lesser number as may result from a plan aimed at bringing the total to 1,300 by 1963.

About half the members are partners or officers in firms doing business with the public -- so-called commission houses. These members execute customers' orders to buy and sell on the exchange and their firms receive the commissions on these transactions. Many firms have more than one member.

About one-fourth of all members of the exchange are specialists -- so-called because they specialize in "making a market" for one or more stocks.

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[1]Eugene Lokey, "The New York Stock Exchange," Fundamentals of Investment Banking, ed. Julien H. Collins (New York: Prentice-Hall, Inc., 1949), p. 533.

The exchange sets specific requirements for specialists regarding market experience, their dealer function, and the amount of capital they must have. As a specialist, his business is concentrated on a particular stock or group of stocks at one trading post. Thus, he can also act for other brokers who cannot remain at one post until prices specified by their customers' buy and sell orders -- either below or above prevailing prices -- are reached. Furthermore, he must subordinate his personal interests in the market to the public's. The specialist, for example, cannot buy or sell in the exchange market at any price for his own account until he has executed all public orders held by him at that price. There is at least one specialist in every stock on the exchange list.

Some members are odd lot dealers. They serve investors who purchase or sell a few shares at a time, rather than in the conventional 100-share unit, known as a round lot. The odd lot member acts as a dealer, not as a broker. He buys odd lots of stock from, or sells odd lots of stock to, other members doing a public business. In most stocks an odd lot is any number of shares from 1 to 99.

Then there are floor brokers, whose function is to assist the commission house brokers. The former are still popularly known as "$2 brokers," although the commission they receive for their services has long been above that amount.

All members -- whatever their function -- must, of course, own a "seat" on the exchange, a term that traces back to early years when the brokers did remain seated while the president called the list of securities. The price of this "seat" is determined by how much a candidate will accept. This price of

membership since 1950 has ranged from $38,000 to $200,000. "Seats currently are quoted at $150,000 bid, $215,000 asked."[2] The initiation fee is $4,000 and dues are about $750 annually.

In addition to the members of the exchange, there are some 3,160 partners in member firms. These partners are known as allied members. There are also 540 holders of voting stock in member corporations who are also known as allied members. Although this type of member may not do business on the trading floor, they are subject to the same strict rules and regulations as are members.

Organization

The rules and regulations governing the conduct of members are set by the Board of Governors, which is elected by the members. The board exercises broad policy-making and disciplinary powers.

Indicative of the national character of the exchange is the composition of its board of governors, which includes members and allied members, and represents all sections of the country. Three representatives of the public who have no direct connection with the securities business bring a broad non-professional viewpoint to the board's deliberations. The chairman, elected annually, must be a member of the exchange. The president, who is selected by the board of governors, brings the membership to thirty-three and may not be either a member of the exchange or a partner of a member organization.

The administrative staff of the exchange is composed of 1,380 employers, of whom 500 work on the trading floor. Offices include the Department of Stock

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[2] The Wall Street Journal (New York), April 10, 1961, p. 10.

List, which examines corporations' listing applications; the Department of Member Firms, which administers policies and rules concerning member organizations' conduct and financial stability; the Department of Public Relations and Market Development, which interprets the Stock Exchange's functions to the public and assists member organizations in their relations with investors; the Department of Research and Statistics, which prepares reports and statistics relating to the listed market and the national economy; and the Department of Floor Procedure, which administers rules regulating trading on the exchange.

The exchange is a rather unusual form of enterprise in that it does not attempt to make a profit and yet it is not a charitable organization, either. It is a voluntary association of brokers which needs enough income each year to operate its extensive market facilities and pay salaries and wages. These expenditures require an annual budget of approximately fourteen million dollars.

The exchange's revenue is derived mainly from members in dues and charges for services and facilities and from fees paid by corporations whose securities are listed. In 1959, revenue from listing fees approximated \$5.5 million; about \$5.9 million came from charges on commissions which members received for executing orders; quotation and ticker services accounted for \$3.8 million; and \$1 million was provided by annual dues paid by the 1,366 members of the exchange.

Linked with the nation's market place is practically every large city in the United States. Some 500,000 miles of telegraph and telephone wires connect the trading floor with 2,820 members' offices and many of those offices with 2,500 non-member correspondents. Member firms have offices in 720 cities

and 49 states and the District of Columbia. There are also member firm offices in 28 cities in as many foreign countries. There can be little wonder as to why the exchange is often termed a keystone in the panorama of business activity.[3]

Corporate Listing Standards

Every company seeking listing on the exchange is judged on its own merits, but, generally speaking, the board of governors places great emphasis on such considerations as: (1) the degree of national interest in the company; (2) the character of the market for its product; (3) its relative position and stability in the industry; and (4) whether it is engaged in an expanding industry with prospects of at least maintaining its relative position.

As far as the financial status is concerned, the exchange requires that each company desirous of listing:

1. Should have demonstrated earning power under competitive conditions of $1 million annually, after all charges and taxes.

2. Should have net tangible assets of at least $8 million, but greater emphasis is placed on the aggregate market value of the firm's common stock where $8 million at the time of listing is required.

3. Is expected to have at least 400,000 common shares outstanding among not less than 1,500 shareholders after substantially discounting odd lots.

4. Must be a going concern, or be the successor to a going concern.[4]

The philosophy behind the stock exchange's listing requirements is this: The investor or trader who owns, buys, or plans to purchase listed securities is

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[3]The New York Stock Exchange, Understanding the New York Stock Exchange (New York: The New York Stock Exchange, 1960), pp. 1-19.

[4]Don G. Campbell, Let's Take Stock (Indianapolis: Bobbs-Merrill Company, Inc., 1959), pp. 85-86.

entitled to information about the corporation which will help him to make his investment decisions wisely.[5]

Corporate management has found many concrete benefits in listing the company's securities on the exchange:

1. Company prestige

2. Daily or frequent trading in its securities with publicly reported prices

3. Superior loan or collateral value of its securities

4. Because its stock becomes well known to investors, new public financing is done more easily and at lower cost (this cost recently averaged 63 per cent less than the cost to other companies).

5. Listing makes the shares more acceptable to large individual and institutional investors

6. Broad active markets attract new stockholders.[6]

The Progress of a Selling Order

If a transaction on the stock exchange be traced from its incidence through to the confirmation of the purchase or sale by a brokerage firm to the customer, a rather comprehensive view may be obtained of the general operation of both the exchange and a member firm.

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[5]The New York Stock Exchange, op. cit., p. 20.

[6]Ira U. Cobleigh, Guide to Success in the Stock Market (New York: Avon Book Division, The Hearst Corp., 1961), p. 24.

Let the order be a sale order. An investor in Dayton decides that he needs to convert 100 shares of General Motors into cash. He will take the highest price that a bidder is willing to pay at the moment the order reaches the Exchange floor, but, at the same time, he wants to know before putting the order in at his broker's office approximately what General Motors is selling for. At his broker's office -- the local branch of a wire house -- he asks for a quotation. The representative who handles his business asks the order clerk to inquire over the wire and the reply comes quickly back from the New York office that 44 is being bid and 44-1/4 is being asked on the floor of the Exchange.

The New York office received the quote from the floor by telephoning to the Exchange's quotation room; this room is high in the Exchange's building but it is constantly in touch by phone with the 17 posts on the floor where business is being transacted. Within a few seconds after the prospective seller in Dayton asked for the quotation, it is received. The market in General Motors being satisfactory, the seller gives his order.

The order clerk hands the written order to a telegraph operator, it is flashed to the New York office and telephoned to the firm's clerk on the edge of the floor. The order calls for a sale at the market -- meaning at the best price General Motors will command when the order reaches the crowd at the General Motors post. The clerk flashes his firm's floor member's number on the annunciator board on the wall; the member goes to the clerk, gets the order, and hurries to the post. By that time General Motors is 44-1/8 bid, offered at 44-3/8, and the last sale, as the floor member sees on the side of the post, was at 44-1/4.

The floor broker desires to do as well for his client as possible. He can follow our instructions -- sell at the market -- by accepting the bid of 44-1/8. On the other hand, having noticed that General Motors is looking firm, as evidenced by the last sale of 44-1/4, he may elect to wait for a little, watching the trend. Should he note that more bids than offers are coming in, he may decide that a slight delay in executing the order may bring his customer an eight to a quarter more than the current bid. The question of judgment and the feel of the market are attributes of good brokerage. But if the state of bids and offers gives him no hint of possible market action for the ensuing few moments, he says sold to the bidder of 44-1/8 and gets the stock off at that price. The contract is completed orally, the members merely exchanging names.

A messenger (a page), of whom there are many on the floor, takes the broker's written record of the sale to the telephone clerk at the floor's edge; the report is phoned to the New York office and transmitted over the telegraph to the Dayton office, where the order clerk sends to the customer a record of the price received.

> If the customer has been watching the stock ticker, or a quotation board in the customers' room, he probably knows just about how much his 100 shares have brought before the report reaches him. That is because a memorandum of the sale, besides going to the firm's New York office from the floor, has also been dispatched by pneumatic tube to the ticker room and sent out over the ticker system into nation-wide distribution.
>
> The customer now has to deliver his stock certificate to his broker -- assuming that it is not already in his account at the brokerage office. . . . Stock Exchange procedure requires that deliveries from seller to buyer must be made by early afternoon of the third day after a sale is made.[7]

The Over-the-Counter Market

In the securities business the term "over-the-counter" is applied to those purchases and sales that are not executed on the floor of an organized stock exchange such as the New York Stock Exchange and the American Exchange. Thousands of issues of stocks and bonds are not listed on any exchange, and even those that are listed may be bought and sold over-the-counter (i.e., outside of the exchanges.[8]

It is a market for securities made up of securities dealers who may or may not be members of a securities exchange. Over-the-counter is mainly a market made over the telephone. Thousands of firms have insufficient shares outstanding, stockholders, or earnings to warrant application for listing on an exchange. Others may prefer not to make public all the information which listing requires. Securities of these companies are traded in the over-the-counter market between dealers who act either as principals or as brokers for

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[7]Lokey, op. cit., pp. 547-549.

[8]George W. Dowrie and Douglas R. Fuller, Investments (New York: John Wiley & Sons, Inc., 1950), p. 58.

customers.[9]

This market is actually by far the largest in the world. Because, however, it has no trading arena of its own, because there is no publicity at all about the volume in issues traded, nor any public record of sale prices or daily ranges, the unlisted market is not properly understood or adequately appreciated.

It is not at all uncommon for a broker in Boston to buy from another in Dallas, Chicago, or Los Angeles. There is a national network of dealers -- several thousand of them. They have no set hours of trading and quite generally start trading before exchanges open and often continue after they have closed. All over-the-counter trades are handled by direct negotiation between dealers. In acting as principal, the dealer buys the security for his own account. In this case, if he resells it to a customer, he will do so at a net price including the addition of a profit for his effort. In such an instance, he becomes, in effect, a merchant of securities. If he acts as a broker in executing over-the-counter orders, he buys at the best obtainable price and charges the customer a standard commission, much as an exchange broker would do. Actually, there are brokers who trade exclusively over-the-counter, and there are hundreds of stock exchange member firms which have a special department for handling over-the-counter business.

In any event, it is most important that the individual deal with a reputable broker in this kind of transaction. Furthermore, before he orders, he should obtain the bid and asked quotations on the particular security

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[9]The New York Stock Exchange, The Language of Investing (New York: The New York Stock Exchange, 1957), pp. 21-22.

desired before effecting any purchase or selling action.[10]

An important question which arises when dealing in the over-the-counter market is one of determining a fair commission to be charged by the dealer who acts as principal in a transaction. Obviously there is no unqualified answer to this. The nearest thing to a standard is the general agreement of dealers that the profit margin should not exceed 5 per cent, unless special circumstances justify a greater charge.

This was the standard arrived at by the board of governors of the National Association of Security Dealers, which represents about three thousant dealers in the country. The N.A.S.D. is much more than just a trade association; it is the official policeman of the over-the-counter business, designated as such by the Securities and Exchange Commission in 1938, and responsible to that agency. The N.A.S.D. has promulgated rules and regulations to assure fair practices, and it has reported a number of violations to the S.E.C.. Through 1958, about one hundred firms had been expelled, and hundreds of others had been censured, fined, or suspended.[11]

Over ninety-five per cent of all government bonds traded are traded over-the-counter. All issues of municipalities are bought, sold and quoted over-the-counter. The shares of all of the country's 14,000 commercial bonds have their market in this medium. Over 40,000 issues of corporation shares are traded or quoted with some frequency over-the-counter. Life insurance stocks such as Aetna, Travelers and Connecticut General, and all mutual fund shares

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[10] Cobleigh, _op. cit._, pp. 24-25.

[11] Louis Engel, _How to Buy Stocks_ (Boston: Little, Brown & Co., 1957), p. 100.

are all over-the-counter items. It is the quality and earning power of the security, not where it trades, that makes it a desirable and rewarding holding.[12]

The "Bear" and the "Bull"

A bear market is a downtrend in the general market, usually continuing for at least a year, when rallies of more than three weeks' duration fall short of previous rallies and when subsequent declines go below the lows of the previous declines.

A bull market is a trend, lasting at least a year's time and sometimes much longer, in which each succeeding intermediate high is above the preceding high and each intermediate decline holds above the previous decline.[13]

The Dow-Jones Averages and the Dow Theory

For decades, traders, analysts, and mathematicians have tried to develop systems which might project, or foretell with accuracy, major future trends in the stock market. Of all these attempts at price prophecy the best-known (and most controversial) is the Dow Theory.

There are excellent full-length books on this subject; and there are, even among dedicated followers of the Dow Theory, some basic disagreements about interpretations. Here it will suffice simply to explain the theory's basic postulates.

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[12]Cobleigh, op. cit., pp. 26-27.

[13]Harold M. Finley, Everybody's Guide to the Stock Market (Chicago: Henry Regnery Co., 1959), pp. 236-237.

Its main premise is this: that the market by its own action predicts or indicates its future direction; and by so doing, provides a quite trustworthy guide as to when to buy and when to sell stocks.[14]

In its most generalized interpretation, it can be outlined as follows:

1. A bull market is signaled as a possibility when an intermediate decline in the Dow-Jones industrial average stops above the bottom of the previous intermediate decline. A bull market is confirmed when, after this has happened, the next intermediate rise in the Dow-Jones industrial average goes above the peak of the last previous intermediate rise.

2. A bull market is in progress as long as each new intermediate rise goes higher than the peak of the previous intermediate advance, and each new intermediate decline stops above the bottom of the previous one.

3. A bear market is signaled as a possibility when an intermediate rally in the Dow-Jones industrials fails to break through the top of the previous intermediate rise. A bear market is confirmed when, after this has happened, the next intermediate decline breaks through the low of the previous one.

4. A bear market is in progress as long as each new intermediate decline goes lower than the bottom of the previous decline, and each new intermediate rally fails to rise as high as the previous rally.[15]

The stocks which determine this composite Dow-Jones average are the common stocks of the following renowned companies:

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[14]Cobleigh, op. cit., pp. 94-95.

[15]Leo Barnes, Your Investments (New York: American Research Council, Inc., 1961), p. 150.

Allied Chemical	General Electric	Sears Roebuck
Aluminum Company	General Foods	Standard Oil of Calif.
American Can	General Motors	Standard Oil of N. J.
American Tel. & Tel.	Goodyear	Swify & Company
American Tobacco	International Harvester	Texaco, Inc.
Anaconda Company	International Nickel	Union Carbide
Bethlehem Steel	International Paper	United Aircraft
Chrysler	Johns-Manville	U. S. Steel
Du Pont	Owens-Illinois Glass	Westinghouse Electric
Eastman Kodak	Proctor & Gamble	Woolworth

Lest the trend of this industrial average contain by chance some bias, the direction, or indicated trend, of the industrial average must be confirmed (correspond to) by similar action in the Dow-Jones Railroad Average.[16]

Dollar Cost Averaging

Dollar averaging is becoming increasingly popular with investors. Basically, dollar averaging is the investment of the same number of dollars in the same security (or group of securities) at regular intervals.

> A system of buying securities at regular intervals with a fixed amount of dollars invested over a considerable period of time, regardless of the prevailing prices of the securities. It is frequently used by institutional investors. Under this system the investor acquires not 10 shares of ABC every month or every six months, but $50 worth of ABC. When ABC is selling at a low price he gets more shares than when it is selling at a high price. Over the long-term if the price trend of a stock is upward, and periodic investments are maintained in good times and bad, dollar cost averaging may be a rewarding investment technique.[17]

The best type of issues for dollar averaging must combine three characteristics:

1. Volatility. The more the price of the stock changes, the more profit the investor is likely to make in the long run over a complete market

[16]Cobleigh, op. cit., pp. 95-96.

[17]The New York Stock Exchange, The Language of Investing (New York: The New York Stock Exchange, 1957), p. 9.

cycle.

2. Long-term strength. Dollar averaging will not prove profitable if the stock selected turns out to be in a permanent downward trend.

3. Good, steady dividends. It's true that dividends as such have nothing to do with the dollar averaging formula. But they can help to provide the regular sum needed for periodic investing -- especially in recessions.

The individual can dollar average in three different ways:

1. He can buy stocks for his own account.

2. He can invest through the Monthly Investment Plan of the New York Stock Exchange, or similar periodic investment plans managed by regional stock exchanges.

3. He can participate through an investment club.

For the vast majority of investors, some form of MIP or similar plan with a mutual fund is probably the most effective and most economical way to dollar average.[18]

Margin Buying

> Essentially, buying stock "on margin" means nothing in the world but buying "on credit", and in its pure form it is about as nasty as paying $10,000 down on a $20,000 house and settling the rest in monthly installments.[19]

Once a security buyer has assured a broker of his financial responsibility and opened a margin account, he can then buy stocks just by making a down payment on them. This type of investing is relatively unpopular.

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[18]Barnes, op.cit., p. 160.

[19]Campbell, op. cit., p. 110.

TABLE 27

RESULTS OF DOLLAR AVERAGING -- VOLATILE STOCK
($600 Invested Periodically Through
a Complete Market Cycle)[a]

1 Price of Stock	2 No. of Shares Bought with $600	3 Total Number of Shares Owned	4 Total Amount Invested	5 Current Value of Shares (1)X(3)	6 Net gain (+) Total (5)-(4)	7 or Loss (-) Per Cent (6) ÷ (4)
60	10	10	$ 600	$ 600	$ 0	0%
50	12	22	1200	1100	-100	-8.3
30	20	42	1800	1260	-540	-30.0
25	24	66	2400	1650	-750	-31.3
20	30	96	3000	1920	-1,080	-36.0
25	24	120	3600	3000	-600	-16.7
30	20	140	4200	4200	0	0
50	12	152	4800	7600	+2,800	+58.3
60	10	162	5400	9720	+4,320	+80.0

[a]Barnes, op. cit., p. 160.

It acquired a bad reputation -- deservedly so -- after the 1929 stock market debacle. Speculation ran wild when only a 10% margin or down payment by investors was required to buy shares. Today, it is estimated that fewer than 20% of investors buy margin; and the amount of down payment required is high and stringently governed.

The New York Stock Exchange dictates that no investor can purchase its securities on margin unless the down payment is at least $1,000. Then there are the special requirements set by individual brokers; some, for instance, will not permit a customer to buy any stock on margin unless it sells above $2 or $3 a share.

Finally, and most important of all, there is the regulation exercised by the Federal Reserve Board, which has been empowered by Congress to state, in effect, just what the minimum margin requirements must be. Since 1934, when the board began to exercise its authority, it has set that minimum by requiring that the down payment must represent a certain percentage of the total value of the stock that is being bought on margin. The percentage is changed from time to time, depending on how concerned the board is about inflation and about the amount of stock trading that is done on margin.

The lowest figure which the board has ever set is 40 per cent, and that figure prevailed for eight years, from 1937 to 1945. The highest figure has been 100 per cent, and while that was in effect, from January 1946 to February, 1947, margin buying was disallowed. At present, the margin requirement is set at 70 per cent.

Margin is the speculator's number one tool.

Suppose an individual has selected a stock selling at $50 a share which he thinks is certain to go up. Under a 50 per cent margin rule, he can buy 200 shares of that stock, instead of just 100 shares, with his $5,000. If the stock goes up five points, he makes $1,000 instead of just $500, a 20 per cent profit instead of 10 per cent. That kind of profit can make even a 6 per cent interest which he may pay on his loan look cheap.

But suppose the stock goes down in price?

It's then that his broker may "call" on him to put up more margin -- that is, to increase his down payment. If he can't meet this requirement, the broker has the right to sell his stock -- as much of it as may be necessary -- to raise the required funds.

How much more money might a margin buyer have to put up if his stocks decline? The answer to this is governed by the margin maintenance rules of the New York Stock Exchange and those of the individual broker. The Federal Reserve Board is no longer concerned after the original purchase. . . .

Under the New York Stock Exchange rule, however, a broker must call on a customer for more margin whenever the amount that the customer would have left, if he sold his shares and paid the broker's loan, represents less than 25 per cent of the current value of the stocks.[20]

If the investor is considering buying on margin, he has a simple risk yardstick to apply: Margin buying is safest when it is most feasible; it becomes dangerous when it is least feasible. Feasibility can best be guaged by two tests:

1. The level of margin requirements set by the Federal Reserve Board -- the higher the requirements the less the feasibility.

2. The size of the difference between average stock yields and interest rates on debit balances charged by stockbrokers.

Short Sales

A person who believes a stock will decline and sells it though he does not own any has made a short sale.[21]

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[20]Engel, op. cit., p. 105.

[21]The New York Stock Exchange, The Language of Investing, p. 28.

Although some people consider short selling to be highly dangerous, unethical, and unpatriotic, there are several conservative and thoroughly business-like aspects to this distinctly legal and common practice. When an individual sells common stocks short, he sells shares which he does not actually own but which he has borrowed through his broker. He obligates himself to buy back this stock at an indefinite future date and to turn over to the lender whatever dividends become payable on it. If the stock drops in value, he can buy it back for less than the amount for which he sold it and thus has realized a profit, inasmuch as his only obligation to the lender is to return the same number of shares of the same stock he borrowed, plus dividends. Of course, if the stock goes up in price, he may buy it back at a higher price than he received, thus losing money on the transaction.[22]

Short selling may not be used as a device to depress security prices artifically, and there are rigid rules to enforce this prohibition. No short sale of a stock is permitted except on a rising price. For instance, there might be six separate transactions in a given stock at a price of $45 per share, but no stock could be sold short at $45 unless the price prior to the six transactions at $45 had been $44-7/8, or less.

> Short selling is an interesting approach to the market and a lot of people have successfully used it in the past to make a pot of money. But these successful short sellers, it should be pointed out, have at least one very important thing in common: they have a nervous system chiseled out of living rock.[23]

<u>The Financial Page</u>

To keep abreast of the current market situation, the interested investor need look no further than the financial pages of his daily newspaper.

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[22]Finley, <u>op. cit</u>., p. 142.

[23]Campbell, <u>op. cit</u>., p. 130.

Here he will find much important information about business in general and about individual companies -- their plans for expansion, their new products, their sales and earning records. Some of these news stories dealing with individual companies may be a little on the optimistic side, since they are often based on publicity releases furnished by the companies themselves, but every responsible newspaper today makes an effort to be as objective as possible in the handling of such news.

A standard feature of the financial section in every big-city newspaper is the daily column in which the action of the stock market is reported and often analyzed in terms of various technical factors -- the primary trend, the secondary movement, the resistance levels, and so on.

Most daily newspapers carry at least some sort of table of activity on the New York Stock Exchange, as well as less extensive listings on the American or Midwest stock exchanges and additional listings of local, over-the-counter stocks. How completely the newspaper covers this area is directly traceable to both the editor's concern with complete coverage and the amount of space he can devote to the subject.

Fortunately, most of today's metropolitan papers carry expanded market quotations. Here, for example, is how The Wall Street Journal handled National Cash Register on a day of trading:

1960-61 High	Low	Stocks	Div.	Sales in 100s	Open	High	Low	Close	Net Change
83 3/4	49 7/8	N Cash R	1.20	68	83 1/8	83 1/2	81	81 3/4	-1 5/8[24]

[24] The Wall Street Journal (New York), March 9, 1961, p. 22.

The reader is told that National Cash Register had a fairly uneventful day of trading during which the volume of stock trading hands was moderate -- 6,800 shares. And, after opening at $83.125 a share, the stock moved up $0.375 a share but then subsequently fell at some point in the trading to $81, closing the day at $81.75 a share, at a loss of $1.375. From the table the reader can also see that National Cash Register on this particular day was trading slightly lower than its high for the year ($83.75) but was still a long way from falling to its low point of 1960-61 ($49.875). It can also be noted that, so far, the company has paid out $1.20 a share in dividends -- based on current annual rate.[25]

This type of coverage -- all of it comprising less than two and a half inches of type -- gives a tremendously broad picture of a stock's past and present performance in an amazingly small amount of space.

Obviously, if he reads the financial pages of his newspaper, the investor will gain something of an insight into the particular securities in which he has personal interest and also of business in general.

Put and Call Options

The more daring traders are constantly searching for devices that will multiply their gains by the creation of greater leverage. One of these devices is the "put" or "call" contact. They are not securities, but are merely legally valid and binding contracts or agreements. Although among the most sophisticated of trading vehicles, they are quite simple when properly

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[25] Campbell, op. cit., pp. 142-143.

explained.[26]

Puts and calls are options which give the right to buy or sell a fixed amount of a certain stock at a specified price within a specified time. A put gives the holder the right to sell the stock; a call gives the holder the right to buy the stock. Puts are purchased by those who expect that a stock may go down. A put obligates the seller of the contract to take delivery of the stock and pay the specified price to the owner of the option within the time limit of the contract. The price specified in a put or call is usually the actual market price of the stock on the day the contract is entered into. Calls are purchased by those who think a stock may rise. A call gives the holder the right to buy the stock from the seller of the contract at the specified price within a fixed period of time.[27]

Put and call contracts are for 100-share lots and are usually written for 30, 60, or 90 days, but increasingly for as long as six months or more. If the purchaser of a put or call does not wish to exercise the option, the price he paid for the option becomes a loss.

Cost of the contracts varies with (1) the price of the stock, (2) its volatility (the more volatile, the higher the price), (3) the length of the contract, and (4) the demand for and the supply of puts or calls for a given stock.

Before the investor's transaction in any option can show a profit, he must recover not only the price of the option but also any premium above or

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[26]Cobleigh, _op. cit._, p. 76.

[27]The New York Stock Exchange, _The Language of Investing_, p. 24.

below the market at which it may have been sold. Thus, on a stock selling at 25, a 30-day call might sell at 26-1/2 and a 30-day put at 23-1/2. To make any profit on such a call, the stock's price would have to go up to 28 or more.

Markets for puts, calls, and other options are made by put and call dealers and brokers, who bring the seller (or writer) of the option together with the buyer. However, the investor can trade in puts and calls through his regular broker at usually no additional charge.[28]

To exemplify the above type of trading --

> Assume U. S. Steel common is selling at 80. The investor thinks that it is going up substantially in the next six months. Acting on that belief, he can buy 100 shares of U. S. Steel at 80 and pay $8,000 (exclusive of commission and taxes). If Steel common within six months advances to 100, he can sell and realize 20 points, $2,000 profit on his $8,000 investment or a 25 per cent gain.
>
> Suppose that instead of buying the 100 shares, however, he had bought a "call" for $1,100. When Steel common reached 91, he would have been "even;" and when it reached 100, he could have exercised his option to buy at 80 and then immediately sold at 100, realizing (gross) $2,000. This way, by investing only $1,100 instead of $8,000, he realized a $900 gain ($2,000 minus $1,100) or a profit on his money of about 80 per cent.[29]

<u>Securities and Exchange Commission</u>

The Securities and Exchange Commission was established by Congress in 1934 to help protect investors. This commission administers the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act, and the Public Utility Holding Company Act of 1935.

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[28]Barnes, <u>op. cit</u>., pp. 117-118.

[29]Cobleigh, <u>op. cit</u>., p. 78.

TABLE 28

EXAMPLES OF PUT AND CALL OPTION CONTRACTS[a]
(January 15, 1960)

100 Shares of Stock	Price for a 90-day Call at the Market	Price for a 6 Mo.'s Call at the Market	Price for a 90-Day Put at the Market	Price for a 6 Month's Put at the Market
American Cyanimid	$525	$750	$450	$600
American Telephone	450	675	375	475
Chrysler	600	875	450	750
General Motors	425	600	350	500
International Paper	800	1,200	700	1,000
New York Central	325	450	250	350
Standard Oil of N.J.	325	500	275	400
U. S. Steel	800	1,100	675	900
Western Union	700	1,100	600	850

[a]Cobleigh, op. cit., p. 77.

Briefly, the Securities and Exchange Commission:

1. Promotes "truth in securities".

2. Regulates not only issuance of new securities, but trading practice with respect to outstanding ones.

3. Has broad regulatory powers over brokers, dealers, advisors, the national exchanges, and the over-the-counter market.

4. Has powers to enforce its determination by legal advice.[30]

The discussion in this chapter has been intended to broaden the Marine officer in the everyday language of investing. By no means have all the techniques and terms of Wall Street been explained -- but, certainly, the most important. It should be further emphasized that this writer has not intended, in describing the techniques of "margin buying," "short sales," and "puts and calls," to infer that such transactions should be employed by the Marine officer. On the contrary, these are tools of speculation and are considered inappropriate for the enterprising investor.

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[30] *Ibid.*, p. 107.

PART III

THE MARINE OFFICER'S PORTFOLIO

CHAPTER VII

THE MUTUAL FUND

In the earlier stages of this report, it was proposed that the Marine officer, who possesses a good perspective of the facts of financial life, should endeavor to align his investment objectives with those of the "enterprising" investor.[1] It was further pointed out that, for many individuals, a combination of self-investment and investment by others would be the most appropriate pursuit toward profitable investment. It is within this framework that the elements of the Marine officer's portfolio will be discussed.

Development of the criteria essential to self-investment has primarily been the subject of Part II. The purpose of this chapter is to describe the investment characteristics of the most rapidly growing medium of indirect investment (i.e., investment by others)-- the investment company -- and to evaluate the most popular of this type of institution -- the mutual fund.

Indirect investment must play an important role in the development of the officer's portfolio. It would be rather unrealistic to discount the opportunities which mutual fund participation holds for an investor of the type to which this paper is directed. Because of this significance, an entire chapter has been devoted to the subject of delegation of security selection.

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[1] *Supra*, p. 107.

Indirect Investment

Before discussing the specific types of outside investment control, it would appear necessary to briefly mention the pros and cons of this type of investment in general. Barnes lists the advantages and disadvantages as follows:

As advantages:

1. Better initial selection of securities and other assets;
2. Closer supervision of assets after selection;
3. More effective portfolio management and improvement;
4. Freedom from care.

As disadvantages:

1. Higher costs;
2. Less flexibility.[2]

It would seem that for the Marine officer's situation, the advantages offered above far outweigh the limitations.

The Investment Company

In the language of the investment markets, the terms "investment trust" and "investment company" are used interchangeably to denote a certain form of investment organization. There are certain technical differences between the two, but these do not affect the general purposes of the organizations, and to only a minor extent do they affect their operations, and then only with respect

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[2]Leo Barnes, Your Investments (New York: American Research Council, Inc., 1961), p. 10.

to more or less mechanical details.[3] So far as this report is concerned, it will make little or no difference which term is employed.

Investment companies are financial institutions which invest the funds of a large number of individual investors in a substantial portfolio of securities, and so obtain advantages that the individual investor might not enjoy through direct investment in securities of his own choosing. There are other institutions, such as banks and insurance companies, that engage in the management of a portfolio of securities but these are established for specific purposes other than investment. The usual purpose of the investment company is to operate a collective fund contributed by a number of shareholders and possibly creditors, each of which, through the medium of the large portfolio, has interest in a variety of individual companies at possibly a very low total outlay.[4]

The basic function of an investment company is to offer an investor the security of diversification and some degree of management supervision in a single investment. It does this by selling its own securities to the public and investing the proceeds in a diversified list of stocks and bonds. Subsequently, these investment holdings may be sold and replaced by others as circumstances warrant. The objectives of the investment company, its method of operation, the types of investment it will make, and the degree of risk it will assume are all matters for decision by the individual company. The investor

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[3]Alec B. Stevenson, "Investment Trusts and Investment Companies," Fundamentals of Investment Banking, ed. Julien H. Collins (New York: Prentice-Hall, Inc., 1949), p. 698.

[4]David F. Jordan and Herbert E. Dougall, Investments (New York: Prentice-Hall, Inc., 1952), p. 548.

chooses the investment company and the type of security in it which meets his needs and his tastes but delegates the burden of studying business corporations, industry trends, and market conditions to the management of his company.[5]

> A prospective purchaser will usually find his market theories reflected in the stated investment policy of at least one of these companies. The wide diversity of securities listed in their respective investment portfolios ensure that the preferences of practically any individual investor will be represented.[6]

Investment companies in the United States are a relatively recent development, most of them having been founded since the early twenties. The idea is allegedly borrowed from the British, who have operated investment companies extensively, but on the whole conservatively, for many years. The American investment company movement did not have a conservative early history; much of its early experience was gained during the boom of 1927-1929 and the depression which followed and is checkered with error, fraud and losses. This era of confusion may be said to have closed with 1940, for in that year the sound and constructive Investment Company Act imposed upon the whole industry the high standards which the best companies had developed through experience. It cannot be said that investment companies are now immune to losses due to management error, but it is fair to state that they are, in nearly all cases, operated openly, honestly, and in the interests of their security.[7]

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[5]John C. Clendenin, Introduction to Investments (New York: McGraw-Hill Book Company, Inc., 1950), p. 401.

[6]Robert U. Cooper, Investments for Professional People (New York: The Macmillan Company, 1959), p. 229.

[7]Clendenin, op. cit., pp. 401-402.

Advantages and Disadvantages

Investment companies make a profession of investment management. Their supervisory staffs work full time in an endeavor to find diversified and attractively priced securities, to purchase them on the best terms, to review, constantly, the list of security holdings, and to sell these securities when either the condition of the market or deteriorating trends in individual issues may dictate.[8] In a feasible classification, these companies provide the general benefits of:

1. Adequate diversification. For most investors, the cost of diversification is prohibitive. Only the very large investor can hope to match the diversification of most mutual funds and closed-end investment companies. For example, to buy only ten shares of each of the 65 stocks in the Dow-Jones industrial, rail, and utility averages would cost the individual roughly $36,000. By contrast, he can buy wide and sound diversification in an investment company for sums as small as $50 or $100.

2. Systematic supervision. Good investment companies have the time, money, personnel, and personal contacts needed to watch an investment once it is made. They can often obtain the information not available to the typical investor until a later date. They can make decisions on portfolio changes which only the exceptional investor can duplicate.

3. Awareness of new developments in industrial technology and techniques. The big profits of tomorrow come from the industrial research of today. Investment companies can follow and take quick advantage of new

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[8]Ira U. Cobleigh, Guide to Success in the Stock Market (New York: Avon Book Division, The Hearst Corp., 1961), p. 66.

developments far more effectively than the individual investor.

4. <u>Investment companies' acquisition costs are inexpensive relative to the output received</u>. The cost of acquiring investment company shares is usually a small price to pay for the careful selection, systematic diversification and skilled supervision a good investment company provides. To buy even as few as 25 securities for $2,500 as an individual, the minimum commission cost would be 6 per cent, or $150. The selling cost would be more, since it would include state and federal taxes. The total buying and selling costs would be about 13 per cent -- compared to about 8-9 per cent for mutual fund shares. Thus, it is usually cheaper to buy investment company shares than an equivalent amount of diversified securities. In addition, the investor gets the advantage of careful selection and continuous supervision.

5. <u>Investment companies will outperform most investors</u>. Only a small percentage of investors have done as well in the stock market as have most investment companies. Even in those exceptional cases, the margin of superiority must be substantial -- and continuously so -- before the individual can feel that he is better off financially as well as psychologically than if he allowed an investment company to manage his funds.

6. <u>Greater convenience</u>. An investment company provides ownership in many different securities without the burden of observing and doing something about the numerous details involved in security ownership (e.g., recording transactions, reinvesting dividends, etc.). Similarly, in the event of death, there are no emergency decisions on portfolio management which have to be made in a hurry.

7. More psychological security. Because an investment company holds many different, diversified securities, any losses it may experience on some of its holdings are either more than offset or substantially reduced by gains on other holdings. The owner of the investment company shares is usually conscious only of the final showing. Therefore, he does not have to suffer the considerable emotional upset of large losses on individual securities.

8. Investment companies provide some tax advantages. For example, when the investor receives a long-term capital gains distribution from an investment company, he can treat it as a long-term gain, although he may have held the investment company shares for less than six months.

9. Performance of investment companies is an open record. Policies, portfolios, cost and performance records of a mutual fund or other investment company regulated by the Securities and Exchange Commission are open to the public.

A possible disadvantage of investment company investment and primarily applicable to long-term investors who plan to hold shares indefinitely would be:

Practice of capital gains distribution by investment companies may lead to dissipation of shareholders' capital. A capital gains distribution is realized capital gain on which the investor has to pay a capital gains tax of up to 25 per cent. Even if he immediately reinvests the capital gains distribution in the same investment company without any additional charge, he has lost the amount of the capital gains tax.[9]

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[9]Barnes, op. cit., pp. 10-11.

Types of Investment Companies

Investment companies are subject to classification by a number of criteria:

1. By degree of managerial discretion. In the management investment companies, the management has power to change portfolio securities at its discretion, subject to any specific restrictions that may be contained in their organization charters or in the law. Unit or fixed trusts have portfolios which are rigid, or nearly so, in which the power of substitution is either denied or rigidly limited. The fixed trust is an arrangement by which the shareholder purchases shares or units representing a proportional interest in a specific portfolio of securities.

2. By arrangements for issuance and redemption of shares. This category includes the closed-end and open-end companies which will be described at greater length in the following pages.

3. By type of capital structure. "Non-leverage" companies (including all open-end funds with one or two exceptions) have only common stock outstanding, although they may gain some leverage benefit from short-term bank loans. "Leverage" companies have outstanding senior capital in the form of bonds or bank loans and/or preferred stock. The "leverage factor" has previously been described.[10]

4. By type of portfolio securities. The portfolio held by the investment company may consist entirely of common stocks, with various degrees of diversification. Or the portfolio may be "balanced," that is, may contain

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[10] *Supra*, pp. 118-119.

bonds and preferred and common stocks of a variety of companies, with the minimum proportions of each type stipulated by the investment company's charter.

5. By degree of risk. Funds range from the very conservative to the very speculative. On the extreme conservative side are funds invested in high-grade bonds; at the other extreme are those emphasizing low-priced volatile common stocks and special situations. The investor must determine, from the announced policies of the management and the character of the portfolio, whether the fund is designed for safety or for high but uncertain income or capital appreciation.

6. By investment purpose. Closely allied to the foregoing is the classification according to the objectives and purposes of the fund. Some funds are designed for regular and modest income, others aim at capital appreciation, while still others hope to produce both reasonable income and growth in market value.

7. By tax status. The majority of investment companies have elected to be classed as "regulated" for tax purposes, in order to obtain the tax concessions provided by the Internal Revenue Act. Classification by tax purpose suggests two groups: (1) companies taxed like other corporations with respect to income derived from interest and dividends and capital gains; (2) "regulated companies" choosing to pay out substantially all net income derived from interest and dividends and which may or may not retain realized capital gains and pay a tax on the same.

8. By type of purchase contract. The shares of fixed or unit-type funds, and of management funds are purchased outright.

9. By type of organization. The fixed trusts and some of the earlier management trusts are trusts in fact; however, most investment companies are now organized as corporations.[11]

The variety of classifications listed above suggests that the investor has a wide choice in his selection of a fund, on a variety of bases. Only the closed-end and open-end companies are of importance here, and this remaining discussion will be confined to them -- largely to the latter (commonly referred to as the mutual fund).

Closed-End Company

A closed-end investment company is an ordinary business concern whose securities are similar to those of any business corporation. It is unusual only because its corporate business consists largely of investing its funds in the securities of other corporations and managing these investment holdings for income and profit. The stockholders and bondholders in this type of company are free to sell their holdings on the securities markets for whatever they will bring or to buy more from others if they are so minded. However, they have no prerogative to ask the investment company to redeem their shares or to sell them additional ones. The company functions as an ordinary business corporation, earning what it can from dividend receipts and market profits and paying dividends when it can. If its operations are extraordinarily successful or promising, the market price of its stock may rise above the net asset value per share of its holdings. If it does not perform well, the market price is certain

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[11] Jordan and Dougall, op. cit., pp. 550-552.

to drop below the asset value.[12]

There are a number of well-known closed-end investment companies whose shares are actively traded on major exchanges. These include Adams Express Company (a joint stock company), Alleghany Corporation, Atlas Corporation, Equity Corporation, General American Investors, Lehman Corporation, and Tri-Continental Corporation. Some of these have broadly diversified market holdings. Adams Express, Lehman Corporation, and Tri-Continental are examples of such. Others diversify less and have heavy or even controlling investments in particular firms. Alleghany Corporation is such an example with very large share holdings in New York Central, Missouri Pacific, and Investors Diversified Services.

Closed-end shares enjoy active trading markets. Their investment results in a given year and the security portfolio at the year end are customarily given in the annual report distributed to all shareholders. Very often closed-end investment company shares will sell in the market at a discount from actual asset value per share of securities owned.[13]

Although closed-end shares oftentimes are available at a discount and are less costly than mutual fund shares, it is more cumbersome and costly to reinvest dividends and capital gains than in the case of mutual fund investment. Reinvestment is not automatic and not commission-free.[14]

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[12]Clendenin, op. cit., pp. 403-404.

[13]Cobleigh, op. cit., p. 66.

[14]Barnes, op. cit., pp. 12-13.

TABLE 29

FULLY DIVERSIFIED CLOSED-END COMPANIES[a]

TABLE 29 - Continued

1		Size 2	Policy 3	Buying Information 4	5	6	Expenses 7	Relative Performance 8	9	10
Company and Age (year founded)		Total Assets (millions)	Common Stock Ratio	Shares Traded On	Relative Amount of Leverage	% Discount from, or Premium (+) over, net Asset Value	Expenses as a per cent of average net assets	Income Return 1954-1959	Capital Growth: 1954-1959 All Payouts Treated as cash	Reinvested annually
12 Closed-Ends-Ave		$ 120	91%	--	--	13%	0.45%	3.29%	62%	75%
Adams Express Co.	('29)	98	96	NYSE	NONE	8	0.44	3.60	87	103
American Intl. Corp.	('15)	41	94	NYSE	NONE	7	0.55	3.53	72	92
Amoskeag Co.	('27)	41	93	O-C	LOW	27	--	4.38	3	7
Cons. Investment Trust	('33)	72	96	O-C	NONE	19	0.12	3.78	70	78
Dominick Fund	('29"	39	89	NYSE	NONE	17	0.39	3.04	30	41
General Amer. Invest.	('29)	68	91	NYSE	LOW	3	0.63	1.73	45	56
General Public Service	('25)	47	91	NYSE	NONE	17	0.48	3.15	66	79
Lehman Corp.	('29)	298	98	NYSE	NONE	1	0.42	2.19	57	65
Madison Fund	('29)	143	92	NYSE	NONE	14	0.62	3.54	46	64
Niagara Share	('29)	64	91	NYSE	NONE	8	0.47	2.83	123	150
Tri-Continental Corp.	('29)	414	68	NYSE	LOW	13	0.26	4.99	73	87
U. S. & Foreign Securities	('29)	119	91	NYSE	NONE	19	0.59	2.73	68	81

[a]Barnes, op. cit., p. 133.

The Open-End Investment Company (Mutual Fund)

While the closed-end funds just described are well known to investors and have done a creditable job of portfolio management, they are overshadowed by their more than two hundred brethren -- the mutual funds.

An open-end investment company is one which continuously offers new shares for sale and which stands always ready to redeem existing shares in cash at the request of any stockholder. Meanwhile, the resources in the possession of the company are invested in securities, and periodic dividends are paid to stockholders as earnings warrant. Although shareholders are free to sell their shares to others or to purchase more from others, it is clear that market prices can never deviate far from the sale and redemption prices set by the company.[15]

Marketing and Marketability

The buyer of these shares pays the net asset value per share (total present value of assets less liabilities divided by number of outstanding shares), which is calculated twice daily, plus a commission or loading charge of from six to nine per cent of the offering price. On large orders there is usually a graduated scale at lower rates.[16] The bulk of this loading charge is retained by the local dealer as sales commission, and the balance goes to the principal underwriter or distributor. The investment company itself is not expected or allowed to shoulder any selling expenses. Ordinarily no charge is made for redemption.[17]

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[15]Clendenin, op. cit., p. 404.

[16]A few funds make no charge at all and sell their shares at net price.

[17]Jordan and Dougall, op. cit., p. 567.

> If you will look on the financial page of any big city newspaper, you will usually find among over-the-counter securities a tabulation of mutual funds. The tabulation will list two figures for each fund. The first figure given (usually at the left) is the "asset value" of the fund or the price you would receive if you turned in a share for "redemption." The second figure is the offering or sales price. This is the price you would actually pay a broker or dealer for shares on a given day.[18]

The public offering price per share must usually be high enough to (1) add a sum equal to the net asset value of existing shares to the company's resources, (2) pay the clerical costs of recording the new share, (3) pay the distributor, and (4) pay the selling group member. This offering price has been the subject of much discussion. If the shares are held for a long period, the initial load, amortized over a number of years, becomes a modest percentage of any income or capital appreciation received. But, where the investor chooses to hold his shares for a short period, the charge may consume any dividends or increase in capital value that may have been gained.

Since the mutual fund shares must constantly be sold on a nation-wide basis, most companies have sales "distributors" to perform this task. The distributor is usually an established securities firm or a selling firm organized for the purpose, which has an exclusive franchise to buy all new shares issued by the investment company. The distributor organizes a selling group consisting of practically all NASD members who are willing to sign the selling group agreement. These selling group members may then receive new shares from the distributor at a concession from the public offering price for sale to their customers. In effect, most brokers and investment dealers sell mutual funds.[19]

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[18]Cobleigh, op. cit., pp. 68-69.

[19]Clendenin, op. cit., pp. 404-405.

Mutual funds are, of course, marketable securities, but their market is unique in that selling does not represent transfer of shares from one holder to another but redemption of the shares by the trust itself.

Types of Funds

Mutual funds themselves differ widely according to the purposes they aim to serve and the investment policies which guide them. There are basically six main varieties: (1) balanced funds providing broad, general diversification among all classes of securities, (2) bond funds, (3) common stock funds, (4) growth funds, (5) income funds, and (6) funds which specialize in investment in particular industries.[20]

Advantages and Disadvantages

Mutual funds are attractive because they can be tailored to the individual's own needs. Here in a single package, even in a single stock certificate, is presented to the individual a complete investment program. Diversification to the extent desired is available, with some funds spreading their resources over several hundred different issues. Constant supervision by trained professionals tends to assure superior performance in selection of securities and, when necessary, the eliminating of issues no longer serving their original purpose. Moreover, the simplification of investment records appeals to many.[21]

Bernes lists the pros and cons of this type of investing as follows. As advantages:

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[20]Cobleigh, op. cit., p. 69.

[21]Ibid., p. 70.

1. Automatic compounding possible. Many mutual funds provide for reinvestment of both income and capital gain dividends at no cost or at reduced cost. This feature of mutual funds permits automatic, systematic compounding several times each year. By contrast, the typical individual investor does not promptly and automatically reinvest.

2. Small amounts can be periodically and systematically invested. The individual can invest as little as $50 per month or per quarter in almost all mutual funds. Some funds have no required minimum. This makes possible systematic rather than sporadic investment. Earnings on such systematic investments also start more promptly.

3. Some mutual funds combine life insurance with investment in a single package.

4. Regular withdrawal plans available. Some mutual funds have periodic withdrawal plans which enable the investor to receive regular monthly or quarterly payments out of income -- or even out of capital gains, if he so specifies.

As disadvantages:

1. Mutual funds sometimes overtrade. Some funds turn over each year up to 30 or 40 per cent of their average net asset value in buying and selling securities. This can be very expensive. Commissions and taxes mount up. Also, since funds buy and sell in large blocks, they often have to buy at increasing prices and sell at decreasing ones.

The main reasons why funds may overtrade are:

a. Search for maximum gains leads to frequent shifts of securities from poorly acting stock groups.

b. Frequent capital gains are wanted to sweeten dividend distributions to shareholders.

c. There may be pressure for reciprocal business from stockbrokers who also sell mutual funds to the public.

2. Income dividend reinvestment policies of some mutual funds may be unfair to larger purchasers. Some funds permit income dividends to be reinvested without any additional sales charge. This can be unfair to shareholders who need and use their dividends for current living expenses.

3. Continuous reinvestment of mutual fund earnings can be dangerous. The prompt, continuous reinvestment of income and capital gains encouraged by most mutual funds means the average investor will be buying too much at the wrong time. Mutual funds pay their largest dividends in capital gains when the market is comparatively high. Reinvestment at those high levels is historically dangerous.[22]

> Mutual funds appeal to thrifty, serious-minded investors who prefer to leave investment decisions to the experts. Through outright purchase, or by steady investment out of income on a monthly payment plan, fund investors aim to build a second income, increase their capital, defend against inflation and insulate themselves against the possible perils and pitfalls of market trading.[23]

> When you invest in a mutual fund, you are buying the only stock you will never have to change.[24]

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[22]Barnes, op. cit., p. 12.

[23]Cobleigh, op. cit., p. 71.

[24]John A. Straley, What About Mutual Funds? (New York: Harper & Bros., 1958), p. 149.

TABLE 30 - Continued

	Relative Performance		
	8	9	10
		Capital Growth: 1954-1959 All Payouts	
t	Income Return 1954-1959	Treated as cash	Reinvested Annually
	3.04%	34%	43%
	3.03	39	44
	3.16	45	55
	3.24	39	48
	5.03	18	23
	3.83	45	62
	3.59	52	63
	5.86	25	35
	3.54	59	76
	2.87	55	66
	2.23	115	139
	2.94	65	75
	2.03	98	152
	3.08	45	53
	3.39	67	76

TABLE 30

FULLY DIVERSIFIED MUTUAL FUNDS (Excerpts)[a]

1		Size 2	Policy 3	Buying Information				Expenses 7
				4	5(a)	5(b)	6	
Mutual Fund and Age (year founded)		Total Assets (millions)	Common Stock Ratio	Sales Charge Maximum Per Cent	Income Dividends Reinvested at	Capital Gains Reinvested at	Periodic Investment minimums Insurance (I) Withdrawal(W)	Expenses as a per cent of average assets
<u>Conservative</u>								
Axe-Houghton Fund B	('38)	$137	67%	8.00%	AV	AV	250-10-300-IW	0.86%
Eaton & Howard Bal.Fund	('32)	202	65	6.00	OP	AV	500-50-300-W	0.56
Putnam Fund of Boston	('37)	202	66	8.00	AV	AV	250-50-200-IW	0.53
Wellington Fund	('28)	1,017	62	8.00	AV	AV	250-50-300-IW	0.40
<u>Income</u>								
Keystone Custodian K-1	('35)	64	41	8.30	OP	AV	NO MINS.-W	0.66
Keystone Custodian S-2	('35)	88	100	8.30	OP	AV	NO MINS.-W	0.66
United Income Fund	('40)	240	91	8.00	OP	OP	NO PLAN	0.57
Value Line Income Fund	('52)	86	72	8.50	AV	AV	100-25-NO	0.81
<u>Aggressive</u>								
Affiliated Fund	('34)	596	88	7.50	OP	AV	250-NO-NO-W	0.43
Bullock Fund	('32)	56	81	8.67	OP	AV	250-25-NO	0.44
Dreyfus Fund	('47)	95	91	8.00	AV	AV	150-50-NO-IW	0.75
Fundamental Invest	('32)	599	98	8.75	OP	AV	100-25-NO-IW	0.63
Keystone Custodian S-4	('35)	70	94	8.30	OP	AV	NO MINS.-W	0.66
Loomis-Sayles Mutual	('29)	75	54	0	AV	AV	250-50-NO	0.61
Mass. Investors Trust	('24)	1,558	100	7.50	OP	AV	500-50-300-W	0.18

[a]Barnes, op. cit., p. 132.

Selecting the Fund

It is the investor's problem to decide whether the shares offered by the investment companies described in the preceding pages will constitute better investments than separate securities selected by him on their individual merits.

If he decides upon the former method of investment, then he still faces the problem of selecting a specific fund which is aligned to his personal objectives. In general, if the individual is primarily interested in maximum income for retirement and he is currently approaching this age, then "income" funds are indicated. The general funds do a fine job of diversified investment for safety and income; growth funds may place the investor in a position to increase his capital in dynamic industries. Specialized funds have become quite popular and some have performed excellently.[25]

In any event, a proper choice must consider (1) the degree of marketability desired, (2) the amount of risk which may be borne, (3) whether specialization is desirable, (4) the dividend policy, (5) the performance record, and (6) the price.[26]

Specific reference to table 30 and evaluation of the columns may prove helpful in this determination. In checking the table note the following:

Column 1 -- Age: The year a company was founded gives the investor some idea of its actual experience, particularly in bear markets.

Column 2 -- Size: The size of a mutual fund as shown by its total net assets, is in a rough way a vote of past investor confidence in the management

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[25]Cobleigh, op. cit., p. 70.

[26]Clendenin, op. cit., p. 421.

of the company.

Column 3 -- Investment policy: This figure indicates the percentage of the value of its portfolio invested in common stocks and is a rough clue to the conservative or aggressive approach of the investment company.

Column 4 -- Sales charge: This column tells how much it costs to purchase a mutual fund.

Column 5(a) and 5(b) -- Reinvestment costs: These columns indicate what it costs to reinvest (a) income and (b) capital gain dividends received on mutual fund shares. Where the individual can reinvest his dividends at the asset value per share (AV), he does not have to pay the sales commission shown in column 4. Where he has to pay the offering price (OP), this means he must pay a sales charge on the dividends he reinvests.

Column 6 -- Accumulation, withdrawal, and insurance plan features: This column summarizes the periodic investment, accumulation, automatic withdrawal and life insurance plans available from each fund. Three figures are usually shown. The first is the minimum initial payment required; the second is the minimum subsequent payments called for; and the third is the minimum annual commitment asked for by the fund. If a fund has an insurance feature available, this is indicated by the letter "I". If a fund has an automatic withdrawal plan in operation, this is indicated by the letter "W".

Column 7 -- Expense ratio: This column reveals how much it costs a company, relative to its average net assets, for its operating and management expenses in its last fiscal year. These figures are almost always less than one per cent.

Column 8 -- Dividends: Here is noted the average annual dividend yield earned by listed investment companies for the five years covered.

Columns 9 and 10 -- Capital growth: These columns show five-year investor results under two different assumptions as to how the investor reinvested, or did not reinvest, the income dividends and capital distributions he received in the five-year period covered.

TABLE 31

DISTRIBUTION OF SHARES IN PORTFOLIO OF MASSACHUSETTS INVESTORS TRUST[a]

Industry	Per Cent of Total
Automotive	3.0%
Banks and Credit Companies	2.1
Business Machines	7.1
Chemicals	5.3
Construction Materials and Maintenance	4.0
Containers and Packaging	0.3
Drugs and Medical	3.4
Electrical and Electronics	5.3
Food Processing	0.9
Metals and Mining	5.3
Natural Gas	3.8
Paper	3.1
Petroleum	16.5
Photographic Products	2.0
Railroads	5.0
Steel	8.8
Stores	2.6
Tire and Rubber	4.5
Utilities	12.9
Miscellaneous	4.1
	100.0

[a]Annual Report of Massachusetts Investors Trust-1960 (Boston: Mass. Investors Trust, 1960), pp. 16-19.

Final Analysis

At this point, it should be quite obvious that mutual fund shares have a place in the Marine officer's portfolio. In fact, in the writer's opinion they should constitute the principal equity security holdings of this type of investor. In spite of the apparent restrictions imposed by his career pattern upon enterprising investment, the Marine officer like any other professional must protect his savings against inflationary trends. He has not the time, nor the facilities, nor the income to accomplish this through extensive self-investment. Therefore, the soundest and most aggressive approach in his situation is through mutual fund participation.

CHAPTER VIII

COMMON STOCK SPECULATION -- A CHALLENGE

The final pages of this report have been reserved for a discussion of the remaining and minor portion in the development of the Marine officer's portfolio (as proposed by this writer) -- common stock speculation. In this chapter, discussion will be limited to an explanation of the basic characteristics of the "glamour security of Wall Street."

To even suggest that speculation in common stocks might be in order for the Marine officer is possibly presumptuous on the writer's part and open to refutation. Nevertheless, self-investment in common shares is the desire of many an investor and certainly a challenge to all. And, there is no reason to believe that a military officer, with adequate knowledge and funds and a predominantly sound portfolio structure, could not aptly round out his investment program with a representative holding in this type of security.

In this chapter emphasis will be placed on common stock characteristics from the point of view of self-investment. In the previous chapter, the designer of the Marine officer's portfolio recognized the utility of this marketable security in the medium of indirect investment -- that is, the mutual fund. The important thing for the reader to grasp is the significant difference in the degree of risk involved in the more direct course of action.

It should be noted that many of the essentials of common stock investment have been explained in previous sections of the paper. No report of this type could have logically progressed to this stage with no mention of common stock. In fact, in most treatises on investment, common stock is discussed in the initial stages; for the common share is actually the "core" of investment.

> There's nothing commonplace about common stock. It's the Number 1 security in our system, basic to all corporate business.[1]

It is left for this chapter, only to define it and highlight its attributes in relation to the economic system and the Marine officer's program.

Speculation versus Investment

To provide the general framework of this report, "investment" was initially described to denote the commitment of present funds for the purpose of deriving a future income. At this point it is necessary to delimit its meaning as it is contrasted to "speculation."

The nebulosity of the term "investment" was recognized in Chapter I.[2] It would naturally follow that "speculation" is no less difficult to define. Much disagreement exists among the experts as to the degree of distinction between the two concepts. This writer will not attempt to resolve the predicament here; but, instead, will filter a few significant elements from some of the many theories which distinguish between the two in order that an appropriate setting may be established for the following discussion.

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[1]Louis Engel, How to Buy Stocks (Boston: Little, Brown & Co., 1957), p. 8.

[2]Supra, pp. 14-15.

The line of demarcation between investment and speculation is difficult to draw because of the loose manner in which the terms are used. The difference is more in degree than in kind. In the traditional sense, the distinction is on the basis of the degree of risk assumed: Speculation involves the purchase of high-risk securities, whereas investment involves the acquisition of low-risk media whose future income is relatively certain.[3]

> High-quality bonds are said to be "of investment grade". In this sense, the label "investment" would be restricted to situations promising stability of value and income, a modest rate of return, and relatively little chance of spectacular capital appreciation. People who seek high-income yields or large capital gains are therefore said to forsake investment for speculation.[4]

Speculation is commonly aimed at a relatively short-term profit obtained from fluctuating market values, whereas investment is interested in income or in long-range profit due to growth or improvement in an individual situation.[5]

Speculation means the deliberate assumption of risks in ventures which offer the hope of commensurate gains. The hoped-for gains may come in the form of larger income than a safe investment would supply. More probably, the speculator hopes that his "investment" will rise greatly in market price, as its earning power increases or becomes more secure. Or he may expect its value to "go up" because of current conditions. It is commonly said that the owners of speculative commitments are more interested in profits from price appreciation than they are in the incomes from their properties.[6]

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[3]David F. Jordan and Herbert E. Dougall, <u>Investments</u> (New York: Prentice-Hall, Inc., 1952), p. 4.

[4]John C. Clendenin, <u>Introduction to Investments</u> (New York: McGraw-Hill Book Co., Inc., 1950), p. 2.

[5]George W. Dowrie and Douglas R. Fuller, <u>Investments</u> (New York: John Wiley & Sons, Inc., 1950), p. 9.

[6]Clendenin, <u>op. cit</u>., pp. 2-3.

> An investor is a man who is willing to take a moderate risk with his money for the sake of earning a moderate return. A speculator is a man who takes a big risk for the sake of making a big profit as a result of an increase in the value of a security.[7]

The foregoing comparisons seem to conveniently tend to the conclusion that U. S. Government securities and corporate bonds and preferred stock would fall into the category of investment type securities while the common equities are of the speculative type of investment. Although this distinction provides the setting for this paper, it is by no means a universal truth. It would seem illogical to dignify a poorly secured bond as an investment and ignore a strongly entrenched stock merely because the owner of the former is interested in income and the stockholder is interested in capital appreciation.

It would be more realistic to hold that within each category of investment media there exist issues which may be termed speculative and also items of the investment-type. And further -- that every investment has some speculative risk, however slight, and any speculation may prove to be a profitable investment.

It is difficult, if not impossible, to draw an exact line of demarcation. There are extremes, of course, that would be agreed on by nearly everyone -- situations that would universally qualify either as investment or as speculation.

For the purposes of this paper, distinction is based upon the degree of expectation the individual may have that his principal plus a satisfactory rate of return will eventually be recoverable. In this context then, all

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[7]Engel, op. cit., p. 10.

common stocks, regardless of the soundness or prominence of the issuing corporation, will be regarded as speculative investments. Their quoted prices are subject to unpredicatable fluctuations of the stock market and, consequently, the purchaser has no assurance that he can ever resell any given share at a price as high as he paid for it.

It should also be mentioned that there is nothing immoral or undesirable about reasonable speculation. The basic difference between investment and speculation probably can be resolved as a matter of degree of risk, and few personal investment programs need be confined exclusively to ultrasafe items. Indeed, the nation would never have new industries or progress at all if speculators did not venture into untried projects.

Common Stock Defined

> Common stock may be defined as the residual ownership of a corporation, which is entitled to all assets and earnings after the other limited claims have been paid and which has the basic voting control.[8]

In short, common stock is the fundamental ownership equity. The claim of the common stockholders to income and assets is subordinate to all other claims, except in the relatively few instances where preferred stock is not preferred as to assets. Common stocks are often termed "equities," since they usually represent only part of the total capitalization as contributed by the owners, in contrast to the remainder supplied by the creditors.[9]

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[8]Clendenin, op. cit., p. 69.

[9]Jordan and Dougall, op. cit., p. 82.

No private business corporation is without common stock, most of them draw the major portion of their funds from their common stockholders, and nearly all are managed basically in the interests of the common stockholders.

The investor in common stock thus occupies a position directly comparable to that of the owner of a farm or a factory. Successful operation means in either case good income from the business, and increased value for the investment; losses mean the opposite. Common stock bears the main burden of the risk of the enterprise and also receives the lion's share of the advantages of success; it is the potent and dynamic element in corporate financing and the one which commands the highest concentration of investor interest.[10]

Common stocks may have a stated par value such as $50 or $100 or $1; or, more commonly they may have no par value. Fifty years ago almost all common shares had stated par values (usually $100). This figure representing par value actually was supposed to represent the original capital contribution made into the corporation. But accountants realized, in due course, that the original contribution, say $100, would not remain as a permanent value, but would change drastically. It would attain much greater value if the company proved a good earner; and it would shrink if earnings did not materialize as original assets depreciated. So, gradually, par value in common stock came to be regarded as a fiction, and, today, either a quite nominal figure from 10¢ to $1 or no par shares are used.[11]

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[10] Clendenin, op. cit., p. 69.

[11] Ira U. Cobleigh, Guide to Success in the Stock Market (New York: Avon Book Division, The Hearst Corp., 1961), pp. 18-19.

Investment Characteristics

One might call the twentieth century the age of the common stock. For, since the early 1900's common stocks have not only become desirable but widely sought for long-term investment. There are several reasons for this: (1) the sustained growth of the economy; (2) the remarkable expansion in size and profitability of this country's great corporations, such as General Motors, International Business Machines, du Pont, General Electric, and Texas Instruments; (3) the fabulous rise in dividend payments over the years; (4) the amazing fortunes made by even modest investment in many companies in their early stages; (5) the defense common stocks have offered against inflation and a depreciating dollar; (6) dissemination of accurate information about corporate affairs; and (7) active daily trading markets.

The common stock is now an accepted and much sought after investment not only by individuals but by mutual funds, endowments, trusts, pensions, savings banks, and life insurance companies. In 1959, Harvard University, the wealthiest private educational institution in the U. S., had over half its endowment funds in diversified common stocks.[12]

On the whole a common stock may be said to have the following characteristics:

1. It normally has control of the corporation and will exercise that control in its own interests.

2. It has unlimited ownership rights to the remaining gains from the business, after other security holders have received their (usually) limited contractual payments.

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[12] *Ibid.*, p. 19.

3. It bears the principal hazards of the business, because other security holders, creditors and employees usually have prior claims, and its quality depends importantly on the amount and nature of the prior claims.

4. Common stock may be sold by its holder to any willing buyer; but, in the ordinary course of business, it does not come "due," hence need never be redeemed by the corporation; nor may the corporation ordinarily "call" it for redemption or force the stockholder to surrender it against his wishes.

5. The earnings on the common stockholders' equity may be unstable. Not only will the corporation's total earnings fluctuate as business conditions change and its own affairs progress, but all the creditors and preferred stockholders must be allowed prior rights, thus making the residual share more unstable than the total.

6. Dividends may fluctuate. Dividends must depend on earnings, cash position, surplus position, expansion needs, debt situation, and management policy. Even if management desires a stable dividend rate, it may not always be feasible, for expansion, debt retirement, and cash accumulation are often more important to the corporation.

7. Dividends are normally less than the earnings on the common stockholders' equity; hence the value of that equity should grow as a result of the investment of the undistributed earnings in the business.

8. Common stocks, in general, are a price-level hedge. That is, they tend to earn, pay dividends, and bring market prices at levels which are vaguely related to the general commodity price level.

9. Common stock prices fluctuate extensively. These fluctuations are so extreme that even in high-grade stocks the timing of purchases and sales is

a major investment problem. Large profits or losses on such investments are, therefore, commonplace.[13]

The owner of sound common stocks is in a favorable position to benefit from any future prosperity and growth of the nation. Normal increases in population, rising standards of living, and the constant development of more desirable consumer goods -- all contribute to a steadily growing demand for the products and services of the country's corporations. Where these corporations are ably managed, they are certain to share in this prosperity.[14]

Advantages of Common Stock as an Investment

While it is usually dangerous to generalize about the investment qualifications of any group of securities as a class, because of the wide variation in quality within any one group, certain observations concerning common stocks as investments may be hazarded.

1. Higher yields. Over the years, common stocks have typically yielded more than fixed-asset investments like government or better quality corporate bonds, savings deposits, and savings and loan shares. However, for most of 1958, 1959, and 1960, this has not been the case.

The fear of inflation has sharply increased the demand for stocks, thereby driving their prices up and their yields down. On the other hand, the willingness and downright eagerness of boom-and inflation-conscious businesses

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[13]Clendenin, op. cit., pp. 70-71.

[14]Robert U. Cooper, Investments for Professional People (New York: The Macmillan Co., 1959), p. 193.

and individuals to go into debt have pushed the demand for credit up to ever-new highs.

2. <u>Probability of long-term capital appreciation</u>. Even when average stock yields drop below average bond yields, the growth potentials of many individual stocks make them superior investment vehicles. For the long term, that is true also for the average stock. The historical record since 1871 bears strong testimony to this attribute. The picture is highlighted in terms of decades in table 32.

TABLE 32

STOCK PRICES OVER NINE DECADES
1871-1959[a]

Decade or Period	Number of years in which stocks Rose	Number of years in which stocks Fell	% price change in period	Average annual change
1871-79	5	4	4%	0.4%
1880-89	5	5	8	0.8
1890-99	6	4	13	1.3
1900-09	8	2	71	7.1
1910-19	6	4	-13	-1.3
1920-29	7	3	140	14.0
1930-39	4	6	-42	-4.2
1940-49	6	4	34	3.4
1950-59	8	2	257	25.7
Totals: 1871-1959	55	34	1,146	12.9

[a]Leo Barnes, <u>Your Investments</u> (New York: American Research Council, Inc., 1961), p. 17.

3. Stocks provide inflation protection. In the ten years from January, 1951 to January, 1961, the cost of living rose 27 per cent. By contrast, in this same period of time, Standard & Poor's index of 500 leading stocks rose by more than 170%. This country's resources and productive abilities are so great that a monetary inflation induces an expansion of output with the result that, in the end, the better-situated industrial ventures soon prosper and their common stocks experience a better-than-equalizing rise.[15]

Disadvantages of Common Stock as an Investment

The prospective buyer cannot afford to overlook the distinct disadvantages involved in such commitments.

1. From a technical viewpoint, common stocks suffer the double handicap of being junior securities and of having only contingent claims upon earnings. Furthermore, the stockholder faces the probability of a reduction in income and the possibility of permanent capital loss in periods of economic stress.

2. From an economic viewpoint, common stocks suffer the double handicap of being sucject, in varying degree, to the vicissitudes of the business cycle and to the adverse influences of industrial trends. In periods of prosperity, when earnings are good, dividends are regular and the situation is favorable; but in periods of depression, when earnings are poor, dividends may be irregular, and the situation of the stockholder is unenviable.

3. From a political viewpoint, common stocks suffer the handicap of bearing the brunt of public regulation and increased and double taxation (on

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[15] Ibid., pp. 16-17.

both the corporate net income and the dividends received by the investor).

4. <u>From an assessment viewpoint</u>, and most important of all, the erratic and unpredictable action of the prices of common stocks which reflects the greater risk of equities both in individual situations and in the market as a whole makes the problem of the valuation of these securities particularly difficult. Too much may be paid for even a good equity and too little received for it when sold.[16]

Approaches to Common Stock Investment

> Common stocks come in many sizes, shapes, and dispositions. Some are relatively stable, others are highly volatile. Some represent increasing intrinsic value and earning power, others stand for the opposite. Some typically move with the averages, others frequently go their own way.[17]

There are probably almost as many individual approaches to common stock selection for the self-investor as there are varieties of common stock. However, it appears to the writer that there are four more commonly used approaches for purposes of investment, as distinguished from mere speculation on swings in price. These include: (1) the safety approach, (2) the income approach, (3) the growth approach, and (4) the value and financial approach. The aspects of the last method were discussed in Chapter V; the other three will be briefly described here.

Safety Approach

The investor who follows this approach will buy only market blue chips or aristocrats -- so-called "sponsored," "institutional," or "freedom-from-

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[16]Jordan and Dougall, <u>op. cit</u>., pp. 87-88.

[17]Barnes, <u>op. cit</u>., p. 16.

worry" stocks. These have excellent marketability, are highly rated by investment services, and are widely bought by institutional investors.

Essentially, insistence on safety fits in best with the "lifetime investment approach," whose maxim is, "Buy a good growth stock and hold on." However, the quality approach is also suitable for investors who need safe and stable income above all other investment goals.

A basic objection to insisting on high quality securities is that they are rarely cheap. Stocks that are favored by investment companies, banks and trust companies, pension and profit-sharing funds, and other careful institutional investors are in perpetual demand. On the other hand, in buying the market leaders which most well-informed institutional buyers are also purchasing, the investor is in excellent company. These buyers are almost always long-term investors. Moreover, because the floating supply of many leading stocks is shrinking, large capital gains are sometimes possible.

Specific courses of action under this heading would include selecting: (1) stocks the experts like; (2) stocks most widely held by institutions; (3) stocks that have never reduced their dividends; (4) stocks with top quality ratings; (5) stocks with top price stability; (6) top profit-makers; and (7) favorite holdings of bank-managed trusts.[18]

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[18]Ibid., pp. 21-29.

TABLE 33

STOCKS THAT HAVE NEVER REDUCED DIVIDENDS[a]
(Excerpts)

Amer. Express	First Penns. Bank	Manufacturers Trust
Amer. Tel. & Tel.	Gulf Oil	Moore Corp.
Baltimore G. & E.	Hertz Corp.	Pacific Gas & El.
Boston Edison	Hilton Hotels	Pitney-Bowes
Chase Manhattan	Humble Oil	Chemical Corn Exch.
Dow Chemical	Intl. Bus. Machines	Sheraton Corp.

[a]Barnes, op. cit., p. 24.

TABLE 34

STOCKS WITH TOP PRICE STABILITY[a]
(Excerpts)

American Snuff	Ohio Edison	General Elec.
American Telephone	Sherwin-Williams	National Dairy Prod.
Hanover Bank	Southern Co.	Pacific Te. & Tel.
Hartford Electric	Texas Util.	Toledo Edison
Marine Midland	Borden Co.	Union Electric
New England Tel.	Detroit Edison	Corn Products

[a]Barnes, op. cit., p. 25.

TABLE 35

STOCKS MOST WIDELY HELD BY INSTITUTIONS[a]
(Excerpts)

Company and No. of Institutions Holding		Popularity Rank 1960	1959	1958
Standard Oil, N. J.	(930)	1	1	1
General Motors	(781)	2	2	3
General Electric	(756)	3	3	2
American Tel & Tel	(716)	4	4	4
du Pont	(679)	5	5	5
Texaco	(635)	6	6	7
Union Carbide	(617)	7	7	6
Socony Mobil	(534)	8	8	8
U. S. Steel	(534)	9	10	15
Phillips Petroleum	(501)	10	9	9

[a]Barnes, op. cit., p. 26.

TABLE 36

TOP PROFIT-MAKERS IN THE UNITED STATES[a]
(Excerpts)

Profitability Rank 1957	1958	1959	Company	Net Profits after taxes-1959 (mils.)	Stock price change-1959
2	1	1	Amer. Tel & Tel	$1,109	6
1	2	2	General Motors	873	10
3	3	3	Standard Oil, N.J.	630	-14
9	20	4	Ford Motor Co.	451	80
5	4	5	du Pont	419	24
7	6	6	Texaco	354	0
6	5	7	Gulf Oil	290	-13
10	9	8	General Electric	280	27
4	7	9	U. S. Steel	255	3
8	8	10	Standard Oil Calif	254	-16

[a]Barnes, op. cit., p. 27.

Income Approach

For almost all investors, income from dividends is taxed about twice as severely as realized capital gains. Unrealized capital appreciation is not taxed at all during a person's lifetime, and may often be handled so as to avoid or minimize estate taxes. In spite of these apparent disadvantages, many individuals employ the income approach to common stock investment. Why? The answer is simply that regular capital gains or uninterrupted capital appreciation are far from a certainty. Individuals invest for income because they need a satisfactory return on their capital even when the nominal value of their capital is not increasing -- or is actually declining, as in 1960.

The logic, strategy, and arithmetic of investing for income will vary according to the individual's income and tax position. In general, the higher his taxable income, the more valuable capital appreciation and realized capital gains, the less desirable ordinary income.

The basic factor to consider in deciding whether to aim primarily for income or for capital gain and long-term growth is the adequacy of one's regular source of income -- both present and future. Thus, if a person's business or profession regularly provides him and his family with more than enough to live as comfortably as he wishes, he will be better off -- taking the lifetime view -- by concentrating on long-term growth and capital gain situations than on large investment income.

When the individual buys common stocks for income, he may have one or more of four different goals in mind:

1. Safe, stable, and regular present and future income.

2. Large near-term income.

3. Large longer-term income.

4. Slowly but steadily increasing income.

He must decide which of these is his primary target, for different stocks are needed to do each job.[19]

TABLE 37

COMPANIES THAT BOOST DIVIDENDS PERSISTENTLY[a]
(Excerpts)

Company	Dividends Rising Since	Number of Dividend Increases	Approximate 1953-60 Price Range
Sherwin Williams	1948	8	33-125
Dow Chemical	1946	11	33-101
Union Carbide	1947	7	62-151
Continental Can	1946	8	23-59
Borden	1938	9	24-50
Gillette	1940	15	16-88
Warner-Lambert	1948	11	8-81
American Natl. Gas	1948	9	25-72
Utah Power & Light	1946	10	14-38
Food Fair	1946	10	16-45
Intl. Bus. Mach	1937	22	40-550
Continental Oil	1938	12	26-70
Shell Oil	1940	8	14-47
Eastman Kodak	1946	14	20-136
Firestone Tire	1946	9	9-50

[a]Barnes, op. cit., p. 35.

[19]Ibid., pp. 29-36.

Growth Approach

Investing for "growth" is a basic aim of most investors. Reference was made to a few aspects of this method of investment in Chapter V.[20] Here a few generalities will be mentioned.

The first distinction the individual has to make is among (1) growth industries, (2) growth companies, and (3) growth stocks. Growth industries are relatively easy to detect -- although there are no sure, permanent growth industries. Growth companies are not too difficult to locate. But growth stocks are very, very difficult to find.

The following benefits accrue to the individual who invests for long-term growth:

1. If growth companies are selected carefully and purchased at the right time, remarkable gains over the long pull are virtually assured.

2. Earnings reinvested by growth companies compound very rapidly, much quicker than the ordinary investor can expect to do for himself.

3. Growth stocks are tax-favored. Tax rates on realized long-term gains are at most half of those on ordinary income, and in no case more than 25 per cent.

4. Growth investors don't have to worry about daily, weekly, monthly, or even yearly price fluctuations.

However, it must be kept in mind that, because of their popularity with institutional and well-to-do investors, good values in growth companies are hard to find. Growth companies are thus almost always overpriced.

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[20] *Supra*, p. 111.

The price premium one usually has to pay for them often substantially discounts their superior growth.

An "ideal" growth company is usually one that (1) has rapidly rising earnings, (2) exhibits improving profit margins, (3) plows back earnings, (4) spends heavily on research and development, (5) has aggressive acquisition policies, and (6) is directed by "stockholder-minded" management. Now, not all growth companies in growth industries are growth stocks. To be a growth stock as well as a growth company:

1. The company must avoid stock dilution. It must not raise funds for expansion repeatedly or exclusively through the sale of additional shares. In other words, corporate growth must pay off to the stockholder on a per-share basis.

2. A growth company must not be overpriced, so that its potential future growth for years to come is already thoroughly discounted.

When considering investment in growth stocks, the individual should observe the following rules:

1. Select genuine long-term growth companies, not simply spectacular beneficiaries of a long business boom.

2. Investigate carefully the long-term growth prospects for the industry in which a stock candidate operates.

3. Don't confuse past performance of a company or industry with future promise. The latter is what is of primary importance.

4. Favor medium-size companies that have room to grow but are still large enough to withstand a period of business adversity.

5. Think twice before investing in a company whose pre-tax profit margins are declining, even though its sales are increasing.

6. Concentrate on conservative dividend payers-companies which plow back at least 60 per cent of net earnings for expansion.

7. Favor dynamic companies which "make their markets" through new products and discoveries.

8. Diversify growth funds among eight or ten firms.

9. Invest in growth companies when their prices are relatively lowest.

10. Avoid buying of growth companies when a bull market is far advanced.[21]

TABLE 38

HISTORICAL GROWTH STOCKS[a]
(Excerpts)

Company	Approximate 1953-60 Price Range
Bendix	25-89
Alum. Co. of Amer.	22-134
Otis Elevator	10-59
Freeport Sulphur	13-41
Revlon	6.70
Raytheon	8-74
Kroger	4-37
Household Finance	19-40
Scott Paper	27-93
Zenith	10-137
Goodrich	30-103
Crown Zellerbach	14-70

[a]Barnes, op. cit., p. 44.

[21]Barnes, op. cit., pp. 37-50.

TABLE 39

"RESEARCH RICH" STOCKS[a]
(Excerpts)

Company	Research Spending % of Sales, 1959
Abbott Laboratories	6
Atlas Powder	5
Litton Industries	20
Lilly	10
Merck & Co.	9
Minneapolis-Honeywell	10
General Electric	6
Polaroid	4
Pfizer	5
Union Carbide	5

[a]Barnes, op. cit., p. 46.

Monthly Investment Plan

At this point any reader might well have surmised, and justifiably so, that the information presented is all well and good, but to put any of it to good use is very expensive and probably beyond the means of a typical Marine officer.

Certainly, investment or speculation in the common stock (regardless of the approach taken) from the viewpoint of the self-investor, requires sufficient funds. This is especially true if proper diversification is to be had. Mutual fund investment overcomes this handicap for most individuals. However, self-investment is a challenge and should not be discounted for lack of vast amounts of funds. The New York Stock Exchange's monthly investment plan was introduced for this very reason. Today, even a person of modest means is able to invest in whichever equity he chooses for as little as $40 per month or quarter.

After he decides how much he wishes to invest each interval, he signs a fully cancellable agreement with any broker member of the exchange. He can arrange to purchase any of some 1,200 stocks listed on the "big board." If he wishes, he may buy several stocks concurrently. Although he buys only one stock per plan, he is permitted two or more plans.

The individual can miss payments without penalty. But a broker may terminate the contract if payments are missed persistently. He is charged the standard round or odd lot commission depending upon the number of shares purchased. He may stop investing under the plan at any time, and upon termination, will receive the number of full shares remaining in his account, plus the dollar value of any fractional shares. The investor may have dividends on the stock paid directly to him or left with his account for reinvestment at the standard commission rates.

MIP, as it is commonly called, is a way of buying stocks on the installment plan -- but there is no credit involved. It is strictly "pay-as-you-go."

At the end of 1960, there were over 100,000 MIP accounts for New York Stock Exchange securities. It is, perhaps, significant that, on the average, the issues selected by most MIP investors have outperformed the general averages in 1959 and 1960.[22]

Final Analysis

> Few investors could avoid buying common stocks even if they wanted to. There are too many all-pervasive economic and psychological reasons for their purchase. Yet investment in common stocks is a risky business which is likely to interfere with that peace of mind which should be what we aim for when we try to gain profits or increase income. The first step toward formulating a philosophy and plan for reducing anxiety in your efforts for dollar-and-cent success is to recognize the motives which impel you to buy common stocks and to differentiate clearly between economic and emotional aims. Your purpose is a basic factor in policy-making.[23]

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[22] Ibid., p. 161.

[23] Linhard Stearns, How to Live with Your Investments (New York: Simon & Schuster, 1955), p. 26.

TABLE 40

FIFTEEN MOST POPULAR STOCKS UNDER THE MONTHLY INVESTMENT PLAN[a]

1.	General Motors	(1,2)[b]	9.	Sperry Rand	(6,6)
2.	General Electric	(2,1)	10.	Minn. Min. & Mfg.	(16,26)
3.	Dow Chemical	(3,3)	11.	Radio Corp.	(11,8)
4.	Amer. Tel. & Te.	(8,9)	12.	Pfizer & Co.	(10,11)
5.	Standard Oil N.J.	(4,4)	13.	Phillips Petroleum	(7,7)
6.	Tri-Continental	(5,5)	14.	Monsanto Chem.	(14,20)
7.	Intl, Bus. Mach.	(9,10)	15.	Safeway Stores	(12,12)
8.	Gen. Tel. & Elect.	(15,33)			

[a]Barnes, op. cit., p. 161.

[b]Figures in parentheses denote corresponding rank one year and two years ago.

Investment in long-term growth common shares should be the goal of the Marine officer whether he chooses to do so under a monthly investment contract, or otherwise. As an owner of sound common stocks he is in a favorable position to benefit from any future prosperity and growth of the nation.

By consistently and regularly investing a portion of his capital in common stocks which have passed his analytical tests, he can gradually acquire a dynamic and diversified portfolio that should be a source of satisfaction and profit. As he acquires proficiency in investment analysis, the officer will probably find it a pleasant diversion rather than an unwelcome task. Speculation is a challenge which the Marine officer should meet.

One last word of caution is necessary. The officer should not adopt the philosophy that he may "get something for nothing." One disquieting reason for the current near-record volume of trading in securities is the effort by many people laboring under this philosophy. Rather, he should pay heed to the words of G. Keith Funston, president of the New York Stock Exchange: " . . . they should exercise the same care in selecting securities as they would in purchasing a house, or car, or in making any other major investment.[24]

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[24] <u>The Evening Star</u> (Washington, D. C.), April 8, 1961), p. A-4.

SUMMARY

The Marine officer is an atypical stockholder. The exigencies of his occupation require that he be more than normally cognizant of essential investment criteria and that he plan his portfolio to provide for the contingencies of his career. It has been the purpose of this report to aid him in these pursuits.

He differs from the average American stockholder in three respects:

1. His occupation requires his frequent dislocation;
2. He seldom has access to professional investment counsel; and
3. His income is somewhat restricted.

Within this framework, the principles of investment have been set forth to provoke his interest and steer his course. Various types of investment media have been discussed to familiarize him with the characteristics of securities. Financial and technical approaches to security selection have been described to furnish him with the technique of investing. The terms of Wall Street have been defined to give him perspective. And portfolio development has been explained to facilitate his planning.

The Marine officer, with a portfolio of insurance, mutual fund shares, and limited holdings in long-term growth stocks can provide for the future of himself and his family, buffer the onslaught of inflation, and play an important role in the entrepreneurship of this country.

APPENDIX

WORDS OF WALL STREET

A short glossary of the more common words and phrases that make up the special language of the market.

Accrued interest. The amount of interest accumulated on a bond, and due to the owner, since the last interest payment.

Amortization. The writing off of depreciation, depletion, expenses and deferred charges; also reduction of indebtedness by regular principal payments.

Arbitrage. A technique designed to take advantage of price differences between different markets or between securities of equal value. A share may sell higher in London than in New York at the same moment -- so that buying in New York and selling an equal amount in London at the same time would create a profit. Exercising the rights to buy a stock may be cheaper than outright share purchase -- so you subscribe, and then sell at a profit.

Assets. Anything or everything that a corporation owns or that is owed to it.

At the market. An order to buy or sell immediately at the best prevailing price obtainable.

Balance Sheet. A complete statement of financial condition on a specified date, revealing the company's net worth.

Bear. A person who believes the immediate market trend is downward.

Bull. A person who believes the immediate market trend is upward.

Bid and Asked. Also called a "quote." It is a report subject to almost immediate change, of the best price that will be paid, and the lowest offering price for a security, at a given moment.

Big Board. Slang name for the New York Stock Exchange.

Blue Chip. A stock of high investment quality usually of a large, well-known company.

Boiler Room. A stock swindler's office, from which high pressure telephone selling of dubious or mythical securities is carried on.

Bond. A long-term corporate promise to pay the holder a given sum of money on a given date, with regular interest at a stated rate in the meantime. Bonds are usually in $1,000 denominations and pay interest semiannually.

Book Value. A bookkeeping term for net worth per share. It is arrived at by adding all the company's assets, deducting from that total all liabilities and debts (and par value of preferred stock if any), and dividing this remainder by the number of outstanding common shares.

Broad Tape. Slang for Dow-Jones news ticker.

Broker. An agent handling customer's orders to buy or sell securities or commodities, on a commission basis.

Callable. A bond or preferred stock that may be redeemed by the company under certain conditions at a certain price.

Capital Gain or Loss. Profit or loss resulting from the sale of a capital asset.

Capital Stock. All the securities representing ownership in a business, including both preferred and common stocks.

Capitalization. The entire amount of securities, of all descriptions, issued by a corporation.

Collateral. Property or securities pledged by a borrower to assure repayment of a loan.

Common Stocks. Securities representing the ownership of a corporation. Holders of a common stock usually have the sole right to elect directors.

Convertible. A bond, debenture, or preferred stock that may be exchanged for common stock (or another security) on certain stated terms.

Coupon Bonds. Bonds carrying interest coupons to be clipped when due and presented for payment by the holder. (Usually the coupon is deposited at the holder's bank for collection and credit.)

Cumulative. A provision in preferred stocks and in certain income bonds, that payments, not made when due, may be made up at a later date. Such accumulations must be paid off prior to dividends on common stocks.

Curb Exchange. Former name of American Stock Exchange.

Day Order. Order either to buy or sell that expires at the end of the day it is given, if not executed.

Dealer. An individual or firm in the securities business doing business as a principal rather than as agent or broker.

Debenture. An unsecured long-term promissory note of a corporation.

Director. A person nominated and elected by shareholders to join the board of directors which guides the corporate destiny.

Dividend. A payment either in stock or in cash distributed pro rata among outstanding shares.

Dow Theory. A system of projection of future market trends based on market performance of the Dow Jones Industrial and Railroad averages.

Equity. Ownership of either preferred or common shares in a company.

Ex Dividend. A phrase denoting that any one buying a given stock will not be entitled to receive the dividend last declared and payable.

Extra. Denotes any additional or extra dividend either in stock or cash, above the regular rate.

Face Value. The amount in dollars written upon the face of a bond.

Fixed Charges. Usually interest charges which must be paid, whether earned or not, before any payment to equity holders.

Flat. Means that a bond trades without any accrual of interest from the payment date.

Floor. The trading area of a security or commodity exchange.

Funded Debt. Long-term indebtedness whether bonds or bank loan.

Gilt-Edged. Slang for a very well secured bond quite certain to pay interest under any economic condition.

Good delivery. A security offered in proper form to assure correct passage of title to a new owner.

G.T.C. order. One which remains good (in effect) until cancelled.

Guaranteed Security. One which has interest, principal, or dividend payment guaranteed by an agency other than the issuer.

Holding company. A company owning the securities of another (usually a controlling interest).

Income Bond. A bond fixed as to amount and date of principal payment, but which pays interest only if and when earned.

Indenture. A legal document reciting the terms and conditions under which debt securities are issued, and defining rates and dates of interest payments, the bond maturing date, and any "call" provisions.

Investment Banker. Usually an underwriter of securities who buys from a company or individual and resells to the public.

Investor. A security buyer interested in protection of principal and reliability of income and to less degree, capital gains.

Investment Trust. A company whose business it is to invest in other companies; most commonly, a mutual fund.

Legal List. A list of securities (in any state) which qualify as legal investments for savings banks and trust funds in that state.

Leverage. The use of other people's money to multiply the buying or earning power of your own.

Liabilities. All claims against a corporation.

Lien. A legal claim against property pledged to secure a loan.

Listed Stock. A stock listed on a stock exchange.

Long. Owning specific securities.

Management. The board of directors and the actual operating officials of a company elected by it.

Margin. Buying a security by providing some of the funds needed and borrowing the rest.

Market Price. The last reported sale price of a given security.

MIP. Monthly investment plan for buying listed stocks with minimum payments of $40 a month.

Mortgage. A lien on property to assure repayment of money borrowed.

Mutual Fund. An open-end investment trust.

NASD. National Association of Securities Dealers, regulating and policing the trading in over-the-counter securities.

New Issue. A corporate security offered to the public for the first time.

<u>No Par</u>. A security without stated or nominal value.

<u>Not a New Issue</u>. Securities not being offered for account of issuer.

<u>Odd Lot</u>. An amount of stock traded in less than the standard unit (usually 100 shares).

<u>Over-the-counter</u>. A market for securities which are usually not listed on any exchange; used interchangeably with "unlisted market."

<u>Paper profit</u>. Unrealized capital gain on a security holding.

<u>Par</u>. The face amount of a bond, or the value in dollars (or cents) assigned to an equity security by the company's charter.

<u>Point</u>. Usually a change of $1 in the price of a stock and $10 in the price of a bond.

<u>Preferred Stock</u>. A class of equity entitled to dividends before common stock; and to a certain amount in liquidation ahead of any distribution to common stockholders.

<u>Premium</u>. The amount by which a bond sells above its face amount; or the amount of an advance of new issue over its offering price.

<u>Prospectus</u>. A circular, required by, and submitted to SEC, which describes securities to be offered to the public.

<u>Proxy</u>. The designation by a stockholder of the right to vote his shares at a corporate meeting, by another person eligible to vote.

<u>Puts and Calls</u>. Option contracts permitting their owner to buy or sell a certain amount of stock at a specified price during a stated period of time.

<u>Rally</u>. A market rise following a decline.

<u>Redemption Price</u>. The price at which a bond may be called in before its maturity or a preferred stock retired at the option of the company.

<u>Refinancing</u>. New securities sold to replace old ones.

<u>Registered Representative</u>. A customer's broker.

<u>Registration</u>. The supplying of information to SEC about a company and the security it proposes to issue; or the recording of securities in the name of an owner (individual, joint or corporate).

Regular delivery. Delivery of securities to buyer on or by the fourth business day after a sale.

Right. The privilege going with each share of stock, to subscribe to new securities in a given company.

Scrip. A certificate exchangeable for either stock or cash during a specified time period.

SEC. Securities and Exchange Commission.

Secondary Distribution. Resale of stock already outstanding, usually for account of large holders.

Short Sale. The sale by a person of a security he does not own, in the belief that he can buy it back cheaper at a later date. Meanwhile he borrows the security in order to make delivery.

Sinking Fund. Money set aside in a special account to redeem, or buy in the market, bonds or preferred stock of a company.

Specialist. A broker on the floor of an exchange whose duty it is to make an orderly market in a particular issue, and to act as broker for other brokers in those issues in which he specializes. Over-the-counter, an individual or firm making markets in a specialized group of securities, such as banks, utilities, etc.

Split. The division of outstanding shares of a company into a larger total number.

Stock Dividend. A dividend declared and paid in stock instead of cash.

Stockholder of Record. The name of the stockholder as registered on the transfer books of a company.

Switching. Selling of one stock to buy another.

Syndicate. A group of investment bankers or brokerage firms who join together in the underwriting and offering of a security issue.

Ticker. The electronic machine that prints on a tape, in a matter of moments, records of transactions which have just taken place on the floor of an exchange.

Times/Earning Ratio. The multiple of last reported annual earnings at which a stock currently sells.

Tips. Rumors or gossip usually without solid foundation about the probable price trend in a stock.

Transfer Agent. An agency, often a bank or trust company, which keeps a record of the name, address, and holdings of registered shareholders.

Unlisted. See "over-the-counter."

Warrant. A certificate permitting the holder to buy a share (or shares) of stock at a certain price for a specified period of time.

Wire House. A securities firm with branch offices in several cities and wire services connecting them.

Yield. The return on a security at a given price, calculated by dividing the interest or dividend rate into the market price.[1]

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[1]Ira U. Cobleigh, Guide to Success in the Stock Market (New York: Avon Book Division, The Hearst Corp., 1961), p. 24.

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